Corporate Boards at the Edge of Chaos: Shareholder Activism from a Complexity Theory Lens

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ABSTRACT

The increasing influence of offensive shareholder activism driven by hedge funds has become a significant issue for corporate boards. The intervention of shareholder activists often challenges current strategies and the status quo of the corporate governance of publicly listed companies.

Previous studies have utilised agency theory as a lens to explore and explain corporate governance issues. However, these studies have been unable to capture the complexity and the dynamics of Board interactions and provide a comprehensive view of the impact of shareholder activism. This thesis adopts complexity theory as an exploratory framework that views a Board as a complex co-evolving system and examines holistically its multiple interactions with shareholder activists and other stakeholders that together create the company's social ecosystem.

A multi-case study approach was chosen with three international hotel companies selected for analysis. The latter had all undergone one or more attacks from shareholder activists over the same period. Online documentary information was collected and used to construct three case studies. Template analysis was chosen as a tool to analyse the selected cases**.** A template framework was developed based on complexity concepts, principles and language to evaluate the impact of shareholder activism.

The findings reveal that offensive shareholder activism influences the decision-making processes of the Boards of Directors. Macro-environmental conditions, a company's vulnerabilities, shareholder activists' attacks, Boards defence mechanisms and changes in a target company emerged from the analysis of the three cases. The thesis identified enabling conditions that facilitate effective corporate governance at a company level and collectively comprise an 'enabling environment'.

The main contribution of this study is the creation of an integrated model of shareholder activism that offers a chronological overview of the impact of shareholder activism and provides insights into the interactions of Boards with shareholder activists and other stakeholders. This model can be employed by researchers as a tool for analysing social dynamic phenomena and by practitioners to develop efficient and robust defence mechanisms for Boards and companies.

Dedication

To my wife Anna and to my son Nikolas

I love you both dearly

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This PhD has been a long journey for me, during which many people have helped me and inspired me. It is impossible to include everyone, but you are all in my mind.

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List of Abbreviations

CAS - Complex Adaptive System

CFO - Chief Financial Officer

CG - Corporate Governance

CCES - Complex Co-Evolving System

HYC - Hyatt Hotel Corporation

IHG - Intercontinental Hotels Group PLC

IPO - Initial Public Offering

KCM - Kerrisdale Capital Management

M&A - Mergers and Acquisitions

MCM - Marcato Capital Management

MOR - Morgans Hotel Group

NYSE - New York Stock Exchange

OC - Orange Capital LLC

OECD - Organisation for Economic Co-Operation and Development

OTK - OTK Associates LLC

SEC - US Securities and Exchange Commission

SHR - Strategic Hotels & Resorts

TFM - Trian Fund Management, L.P.

YU - Yucaipa Companies LLC

WYN - Wyndham Worldwide Corporation

Glossary

Asset light strategy: A strategy whereby the company has relatively few capital assets compared to its operations.

Buyout (target): The purchase of a company's shares in which the acquiring party gains controlling interest of the targeted firm.

Capital infusion: The injection of funds into an ailing or fledging company by a business benefactor with a financial stake in the company. Capital infusions are typically made by company management to prop up a division or subsidiary.

Confidential voting: Voting that is kept secret and only the vote totals are announced.

Customary standstill provision: A contract that stalls or stops the process of a hostile takeover. The target firm either offers to repurchase the shares held by the hostile bidder, usually at a larger premium, or asks the bidder to limit its holdings.

Delaware: The state where the majority of the largest US companies are incorporated, and its corporate law often serves as the authority that other US states look to when developing their own statutory and case law.

Form 10-K: An annual filing that publicly listed companies are legally required to send to the U.S. Securities and Exchange Commission (SEC). The form contains almost everything about the business that an investor would want to know before buying or selling shares of stock in the corporation or investing in the firm's corporate bonds.

Form 10-Q: A comprehensive report of a company's performance that must be submitted quarterly by all publicly listed companies to the SEC. In the form, companies are required to disclose relevant information regarding their financial position.

Form 13F: A filing with the SEC also known as the information required of institutional investment managers' form. It is a quarterly filing required of institutional investment managers with over $100 million in qualifying assets. Companies required to file SEC Form 13F may include insurance companies, banks, pension funds, investment advisers and broker - dealers.

Form S-11: A filing with the SEC that is used to register securities that are issued by real estate investment trusts or those whose business is acquiring or holding real estate for the purpose of investment.

Holding company: A parent corporation, limited liability company or limited partnership that owns enough voting stock in another company to control its policies and management.

Initial public offering: The first time that the stock of a private company is offered to the public.

Market capitalisation: The market value of a company's outstanding shares.

NASDAQ composite index: The market capitalisation - weighted index of approximately 3,000 common equities listed on the NASDAQ stock exchange. The types of securities in the index include American depositary receipts, common stocks, real estate investments trusts (REITs) and tracking stocks, as well as limited partnership interests.

Pooled funds (Investment vehicles): Funds from many individual investors that are aggregated for the purposes of investment, as in the case of a mutual or pension fund. Investors in pooled fund investments benefit from economies of scale, which allow for lower trading costs per dollar of investment, diversification, and professional money management.

Private investment in public equity (PIPE): A private investment firm's, a mutual fund's or another qualified investors' purchase of stock in a company at a discount to the current market value per share for the purpose of raising capital. This technique is more efficient than secondary offerings, due to fewer regulatory issues with the SEC, and is great for small-to-medium-sized public companies that may have a hard time accessing more traditional forms of equity financing.

Preferred return: A minimum annual return that the limited partners are entitled to before the general partners may begin receiving carried interest.

Preferred securities/stock: A class of ownership in a corporation that has a higher claim on its assets and earnings than common stock. Preferred shares generally have a dividend that must be paid out before dividends to common shareholders and the shares usually do not carry voting rights.

Proxy access: The ability of a long-term shareholder (or a group of long-term shareholders) to place a limited number of alternative board candidates on the company's proxy card (ballot) for the company's annual shareowner meeting. Proxy access also allows the nominating shareowner to provide a brief description of each alternative candidate in the proxy card's accompanying document, known as the proxy statement. Proxy access generally is available only to shareholders who have collectively held at least 3 percent of outstanding shares for at least three years.

Recapitalisation: Restructuring a company's debt and equity mixture, often with the aim of making a company's capital structure more stable or optimal. Recapitalisation can be undertaken for a number of reasons, such as defending against a hostile takeover, minimising taxes or to implement an exit strategy for venture capitalists.

Record date: The cut-off date established by a company in order to determine which shareholders are eligible to receive a dividend or distribution.

Redemption: The return of an investor's principal in a fixed-income security, such as a preferred stock or bond, or the sale of units in a mutual fund.

REIT: A type of security that invests in real estate through property or mortgages and often trades on major exchanges like a stock. They provide investors with an extremely liquid stake in real estate. They receive special tax considerations and typically offer high dividend yields.

Rights offering: An issue of rights to a company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period.

Schedule 13D: A form that must be filed with the SEC under Rule 13D. The form is required when a person or group acquires more than 5% of any class of a company's shares. This information must be disclosed within 10 days of the transaction. Rule 13D requires the owner to also disclose any other person who has voting power or the power to sell the security.

Series A preferred stock: The first round of financing given to a new business once seed capital (initial capital used when starting a business) has already been provided. Typically, this is when external investors are given company ownership for the first time.

Shareholders rights agreement: An arrangement among a company's shareholders describing how the company should be operated and outlines the shareholders' rights and obligations.

Tax Inversion: The process by which companies, especially U.S. - based companies, move overseas to reduce the tax burden on income.

PART 1 - BACKGROUND TO THE STUDY

This study consists of three parts that allow the reader to understand the impact of shareholder activism in a company's corporate governance ecosystem. Part 1 presents the significance and relevance of this study; it reviews the theoretical work and discusses the methods used to undertake the research process.

CHAPTER ONE - INTRODUCTION

1.0 Introduction

The dynamic business environment where publicly listed companies operate is characterised by constant changes that influence their success. These changes influence the way these companies manage their relationships with their shareholders and stakeholders. Shareholders and stakeholder groups challenge the corporate boards of these companies on a wide range of matters such as their profitability, corporate governance, environmental impact and their impact on local communities. They expect the Boards of these companies to comply and meet their demands and expectations and will add significant pressure if their intentions are not followed. Although corporate social responsibility agendas are important for many stakeholder groups, financial performance and corporate governance matter for most shareholders in the business environment. All shareholders expect a return on their investments and some will react if a company does not generate positive results in the short-term. However, there are shareholders who employ a passive approach; they are patient and they are interested in long-term returns on their investments.

The shareholders that tend to be impatient and more proactive when interacting with publicly listed companies are called shareholder activists. Shareholder activists are investors who are looking to benefit financially in the short-term from their investments. They have been present in financial markets since the creation of the corporation and most of their practices have consistently remained the same over the years in order to attempt to generate a quick return on their investments. Shareholder activists attempt to bring about changes in companies that do not perform well from a financial perspective or those which have corporate governance weaknesses. They pressure their ‘targets’ to change their strategic direction and/or the structure of the company’s Board/Management with the intention of improving its performance.

Based on their interests, shareholder activists may take either an active or a passive approach. An active approach indicates the dissatisfaction of a shareholder who has either a short-term or a long-term view of their investment and often results in an expression of the need for changes in a company. In a passive approach, regardless of a company’s performance, a shareholder will not intervene and will not push for any changes (Saft, 2016). The active approach of shareholder activism consists of ‘defensive’ or ‘offensive’ motives that investors may demonstrate while owning a company’s stock (Cheffins and Armour, 2011).

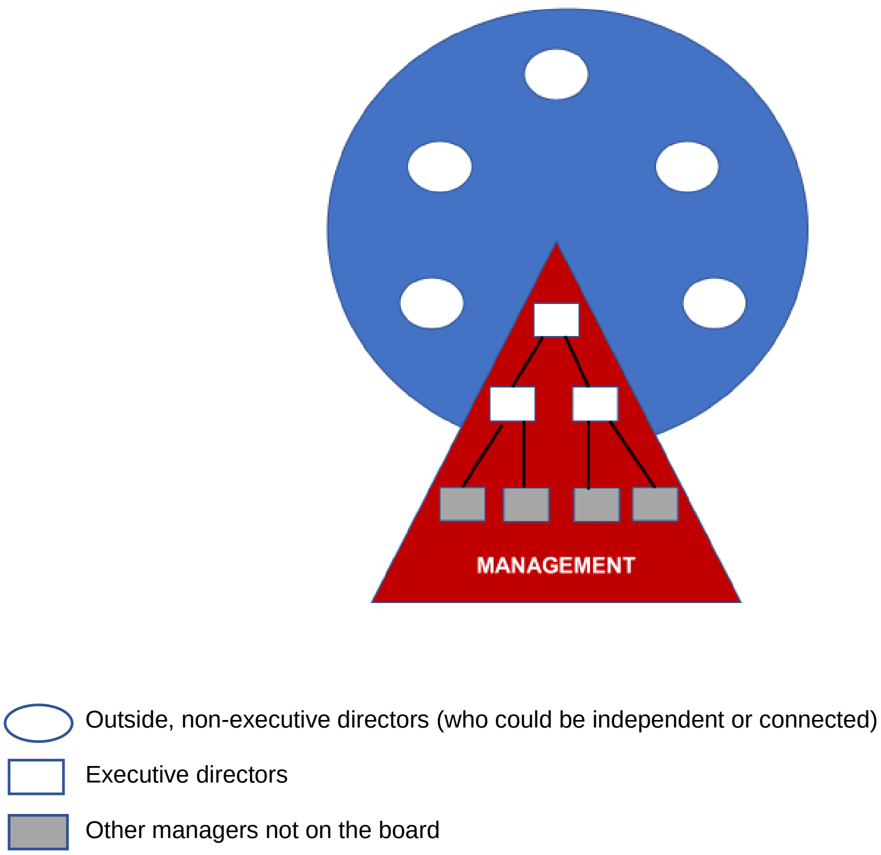
Shareholder activists primarily pursue ‘offensive’ motives. In the past they have targeted companies that are household names and have caused changes in these companies. High profile examples of shareholder activism have occurred in several industries. In April 2017, shareholder activist Jana Partners, bought a 9% stake in Whole Foods and suggested that the company should consider a sale (Daniels, 2017). Three months later, Amazon acquired the company and Jana Partners made a $300 million profit (Morrell, 2017). In August 2013, Carl Icahn, a well-known shareholder activist, announced that he had purchased a stake in Apple and, by January 2014, he increased his stake to 0.9% of the company's outstanding shares at a total cost of $3.6 billion (Lazonick, Hopkins and Jacobson, 2016). Two years later, he successfully pushed Apple to return $250 billion to its shareholders, a move in which he made a $2 billion profit on his investment (The Telegraph, 2017). These examples and the incentives that shareholder activists gain in public interventions are the result of their motivation to constantly pursue targets that will enable them to increase the return on their investments.

1.1 Rationale for this Study

Corporate governance is a term which was initially discussed in 1776 with Adam Smith distinguishing the vigilance of 'public company' directors from that of owners in 'private copartneries' (McCreadie, 2009); it became a field of scholarly study in the 1960s with Eells (1960, p. 108) defining it as '*the structure and functioning of the corporate polity*'. However, it really gained prominence in the beginning of the new millennium after a series of financial scandals such as those involving Enron, WorldCom (Fearnley and Beattie, 2004) and Parmalat (D'Orio, 2005). The resulting losses of shareholders' wealth (billions of dollars) and of thousands of jobs pushed governments and the business world to work together in developing regulatory schemes such as the Sarbanes-Oxley Act of 2002 in the US, the Corporate Governance Code in the UK and Germany and the Financial Security Law in France (Bhasa, 2004).

Company law typically views a publicly listed company as a legal entity subject to rights and liabilities (Tricker, 2012a). There is a formal separation of the company's management (under the Board of Directors) from its owners. Tricker (2012a) further notes that in most jurisdictions, the law does not distinguish between different types of directors nor their separate roles and responsibilities. In practice, however, there are two types of directors on a Board: 'executive' managers in the company and 'non-executives' who are not involved in running the company and often do not have an affiliation with the company, other than the directorship. Figure 1.1 illustrates a comprehensive view of a publicly listed company's governance which not only includes 'executive' and 'non-executive' directors that are members of the Board of Directors, but also other managers who hold senior roles in the company without having a direct influence on the Board.

Figure 1.1 The Board and Management



Adapted from: Tricker B. (2012a) *Corporate Governance, Principles, Policies and Practices*, 2nd Edition, Oxford: Oxford University Press, p.36.

At the core of corporate governance sits the Board (Haspeslagh, 2010). Board members that act as the agents of shareholders are accountable for controlling the management and for evaluating and implementing effective systems of controls (Pergola and Joseph, 2011) that best serve the stakeholders' interests and most importantly the company's shareholders.

Hedge funds are strong advocates of offensive shareholder activism; however, other institutional investors such as mutual funds, pension funds, and private equity funds may occasionally adopt an aggressive approach too, although they mostly work 'defensively' to protect the value of their investments (Cheffins and Armour, 2011). Unlike mutual funds, pension funds and private equity funds, hedge funds are highly motivated by increasing their returns on investments on publicly listed companies. The impact of shareholder activism has been investigated by various scholars (Bebchuk, Brav and Jiang, 2015; Boyson and Mooradian, 2012; Ferri and Sandino, 2009). There are streams of studies that have investigated the impact of shareholder activism on their 'targets'. These studies have explored the operating performance of a company; other studies have looked at a company's share price performance and others have looked at the investment returns of hedge funds because of their engagement with shareholder activism. In addition, the extant academic research has examined the types of investments and campaigns that shareholder activists conduct within the corporate environment and the effects they have on other investors (Bebchuk et al., 2015; Boyson and Mooradian, 2011; Gantchev et al., 2017; Schneider and Ryan, 2011). Another stream of research (Becht, Frank, Mayer and Rossi, 2010; Mahlendorf, 2013; Sudarsanam and Broadhurst, 2012) has looked at the impact of shareholder activism on corporate behaviour (corporate governance convergence, changes in accounting systems).

It is suggested that the new era of hedge fund activism began approximately two decades ago, and several scholars have therefore conducted research using data spanning the period from the late 1990s through to 2007 (Brav, Jiang, Partnoy and Thomas, 2015). For example, Klein and Zur (2006) used a sample of activism events from 2003 to 2005 whilst Boyson and Mooradian (2012) studied a sample of 269 events from 1994 to 2005. Schor and Greenwood (2007) examined a large sample of events between 1993 and 2006 that included a total of 20,771 filings, while Bebchuk et al. (2015) studied a much larger sample of approximately 2,000 interventions by activist hedge funds.

Although the focus of practitioner and scholarly analysis of the phenomenon of shareholder activism has often varied from financial performance to governance performance and operational performance, it is clear that the impact of shareholder activist interventions is not limited to certain aspects of the organisation but fundamentally changes its entire corporate governance ecosystem. What is missing from these studies is a comprehensive view of the impact of shareholder activism that simultaneously looks at the interaction of Boards with their stakeholders.

For this reason, this study employs complexity theory because it enables the complexity and dynamics of a Board's interactions and inter-relations to be captured. Therefore, in an organisational context, it provides an explanatory framework of inter-relationships: of how individuals and organisations interact, relate and evolve within a larger social ecosystem (Mitleton-Kelly and Papaefthimiou, 2002). Complexity theory also provides a rigorous approach to study some of the key aspects of organisations and examines, the unpredictable, disorderly and unstable organisational aspects and complements the traditional understanding of organisations to provide a more complete picture (Kernick, 2004; Zimmerman, Lindberg and Plsek, 1998).

In addition, complexity theory offers a way of understanding and identifying underlying patterns of order, therefore providing a richer understanding and appreciation of situations or processes. It introduces potentiality (possible future emergences) by demonstrating how simple recurrent rules lead to complex behaviour. While systems or entities - people and/or organisations - may exist in various states (having multiple potentialities), complexity illustrates how the state that unfolds is the result of interactive local relationships (Kuhn, 2009, p.12). The understanding of organisational life is facilitated by the fact that complexity theory offers a new imagery and a rich vocabulary that enables researchers to pursue more meaningful, open-ended, and systemic modes of inquiry (Prigogine, 1997). With a range of complexity principles and concepts that according to Mason (2007) have relevance to business, it gives the opportunity to researchers to study corporate governance mechanisms such as shareholder activism.

Complexity theory studies complex social systems comprehensively by looking at the multiple, interacting dimensions that collectively create the social ecosystem (Goergen, Mallin, Mitleton-Kelly, Al-Hawamdeh and Hse-Yu Chiu, 2010). It can view a Board as a complex system that is part of a company’s wider corporate governance ecosystem. A complex system, such as the Board, comprises a number of agents that are independent, interact with each other and whose behaviour is difficult to predict. The outcome of their interactions may have a larger impact affecting the entire corporate governance ecosystem. A corporate governance ecosystem consists of shareholder activists, other shareholders/investors and other stakeholders such as financial media, financial analysts, regulators, enforcement agencies and investment banks that are also viewed as complex systems. Within a company's corporate governance ecosystem, these agents interact with the Board and with each other and influence their evolution. Although complexity theory has been used on some occasions as a lens to explore and understand corporate governance, the studies using this lens on corporate governance to date are very limited (Goergen et al., 2010).

In conclusion, the extant literature reveals a gap in the corporate governance discipline. This study identifies complexity theory as a lens through which to explore the phenomenon of 'offensive' shareholder activism comprehensively by considering the multiple interacting dimensions of the 'new order' that Boards create in companies because of this type of activism. Using a complexity theory lens, it looks at all corporate governance agents and pursues novel insights and interpretations on the impact of shareholder activism on them.

As a result of the gap in the corporate governance discipline, a number of research questions have emerged:

1. How are corporate boards influenced by agents in a corporate governance ecosystem?
2. What is the reaction of corporate boards to 'offensive' shareholder activism?
3. What is the outcome of the impact of shareholder activism on corporate boards?
4. What are the enablers and inhibitors that together create a co-evolving enabling environment?

5. To what extent did the initial conditions and enabling conditions, enable corporate boards to fend off ‘offensive’ shareholder activism?

1.2 Aim and Objectives

Given the above discussion, the overall aim of this study is:

To provide novel insights and interpretations of the impact of ‘offensive’ shareholder activism on a company’s corporate governance ecosystem utilising a complexity theory lens.

This aim of this study will be achieved by the following objectives:

1. Understand corporate boards as complex co-evolving systems, taking into consideration all agents that interact with and influence each other within the corporate governance ecosystem.
2. Develop multiple cases of ‘offensive’ shareholder activism, interrogate the reaction of corporate boards and gauge the impact it has had on the specific corporate governance ecosystem through the collection and qualitative analysis of data gathered from online documentary information (documentation and archival records).
3. Evaluate through a complexity theory lens the multiple interacting dimensions of the ‘new order’ created by corporate boards because of shareholder activism.
4. Identify possible enablers and inhibitors in the corporate boards’ trajectories that together create a co-evolving enabling environment that supports and encourages good governance practices.

5. Propose an integrated model of shareholder activism that will enable corporate boards and corporate governance ecosystems to implement practices that prevent and withstand activist shareholder ‘offensives’.

1.3 Research Context

Corporate governance and the shareholder activism phenomenon are ubiquitous across all industries and shareholder activists have attacked big companies such as IBM, Apple, Pepsico, General Motors, eBay and Dell, to name a few (Deveau, 2018; Picker, 2016; Waldmeir, 2017). A review of the extant research on corporate governance showed that the subject has been researched in the hospitality industry by a number of scholars who have investigated whether corporate governance mechanisms are different in hospitality companies compared to other industries. Other scholars have examined the degree to which the quality of mechanisms and growth opportunities affect agency problems in hotel companies and others have explored the effect of the deviation from optimal franchising on the relationship between corporate governance provisions and firm financial performance in restaurant companies (Altin, Kizildag and Ozdemir, 2016; Dogru, 2018; Dogru and Sirakaya, 2018; Logan, Gooden and Simon, 2013; Madanoglu and Karadag, 2016; Oak and Iyengar, 2009).

However, there appears to be a lack of academic research on shareholder activism in the hospitality industry despite the trade publications coverage of a number of cases. A review of trade publications and analyst reports has shown that the hospitality industry has gained the attention of shareholder activists on several occasions and there have been activists’ interventions over the last 10 years in both the hotel and the restaurant sectors. For example, in the hotel sector, shareholder activists have intervened in companies such as Chatham Lodging, Extended Stay America, Intercontinental Hotels and Resorts, Marriott International Inc., Morgans Hotel Group, Starwood Hotels and Resorts and Strategic Hotels and Resorts (Brandt, 2013; Lombardo and Al-Muslim, 2019). In the restaurant sector, they have targeted companies such as Darden Restaurants, Chipotle, Fiesta Restaurant Group and Buffalo Wild Wings (Maze, 2017). This study intends to fill this gap in the literature by looking at shareholder activism targeting three hotel companies. This context-specific approach will enable the researcher to acquire knowledge from individual case studies and increase the comparability from one sector. In addition, it will allow this study to examine newer social dynamic phenomena such as the impact of shareholder activism in the hotel sector.

1.4 Thesis Overview

As shown in Figure 1.2, this study consists of nine chapters. This first chapter has outlined gaps in the existing literature in corporate governance and shareholder activism. This chapter also sets out the aim, objectives and research questions of this study.

Chapters 2 and 3 critically review the relevant literature associated with this study. The chapters identify and review the literature on corporate governance, the Board of Directors, shareholder activism and agency theory. They also evaluate and review the literature on complexity theory including complexity principles and its relationship to corporate governance.

Chapter 4 evaluates the research design chosen. This chapter describes and justifies the research approaches and methods that this study has employed. The chapter also provides a rationale for choosing a multi-case study strategy as well as how the sample selection has been made. In addition, this chapter discusses the data collection methods employed leading to a justification about the application of data collection analysis methods adopted in this research. The chapter concludes with a reflection on the limitations of the research design.

Based on secondary research, Chapters 5, 6 and 7 provide in detail the background information gathered on each case study and present information about each hotel company and all shareholder activists. These chapters also present the research findings of the selected case studies and offer a detailed context for analysis and discussion in the following chapters.

Chapter 8 brings together and offers an analysis of the research findings. This chapter compares and contrasts the findings gathered within the corporate governance and complexity theory literature. This chapter also discusses the importance of complexity theory in corporate governance research. Finally, Chapter 9 presents the contribution of this research study to the body of knowledge and provides implications for researchers and practitioners.

Figure 1.2 Thesis Structure

Chapter 1: Introduction Research rationale and literature gaps, research aim and objectives, originality of the study, research context	**PART 1 - BACKGROUND TO THE STUDY**
↓	
Chapters 2 and 3: Literature Review Corporate governance, shareholder activism, hedge funds, agency theory, complexity theory	
↓	
Chapter 4: Methodology Research approach, research design research strategy, data collection methods, data collection analysis	
↓	
Chapter 5: Findings of Case Study I The target, the activist, shareholder activism events	**PART 2 - FINDINGS**
↓	
Chapter 6: Findings of Case Study II The target, the activists, shareholder activism events	
↓	
Chapter 7: Findings of Case Study III The target, the activists, shareholder activism events	
↓	**PART 3 - CONTRIBUTIONS AND CONCLUSIONS**
Chapter 8: Discussion Analysis of the research findings	
↓	
Chapter 9: Conclusion Conclusions, contributions, recommendations for theory and practice, recommendations for future research	

CHAPTER TWO - CORPORATE GOVERNANCE AND SHAREHOLDER ACTIVISM

2.0 Introduction

The following two chapters review the theoretical work of this study which consists of the academic subject areas of corporate governance and complexity theory. Chapter 2 discusses the phenomenon of shareholder activism and examines its impact on the corporate governance structure of publicly listed companies, as well as the emergence of hedge fund activists in the corporate landscape and the strategies they employ in the marketplace in order to influence their targets. In addition, this chapter reviews the literature on corporate governance and agency theory and their relationship with shareholder activism. Chapter 3 discusses and evaluates complexity theory and reviews its extensive vocabulary that comprises several principles.

2.1 Corporate Governance

Changes in the listing standards of stock exchanges (NYSE and NASDAQ Stock Market, Inc.), corporate scandals, and the emergence of shareholder activists have prioritised the scrutiny of corporate governance structures and activities (Rubach and Sebora, 2009). Organisations such as the G20, OECD, IMF and World Bank have adopted higher corporate governance standards primarily to manage the risk of corporate failures, to improve economic performance, to enable capital access, and enhance the investment climate (Clarke and Branson, 2012).

The need to increase capital and to enter capital markets has led to the growth of demand for capital in global economies and as a consequence establishing good governance practices has gained momentum (Bhasa, 2004). Although the 20th century experienced growth in management and organisation theories, the 21st century will primarily focus on corporate governance (Tricker, 2012b). This is apparent nowadays as, in the business vocabulary, corporate governance has become one of the most commonly used phrases (Solomon, 2013a).

Various theories and approaches use corporate governance differently, and the term appears in different concepts with distinctive meanings (Schneider, 2012). Therefore, there is no a single, accepted definition of the term, but authorities that focus on corporate governance have adopted a number of definitions. Lessambo (2014, p.3) defines corporate governance as the material obligations that a corporation has towards its shareholders, employees, customers, suppliers, creditors, tax and other supervisory authorities. This definition demonstrates the relationship between the Board of Directors and the company's management with several stakeholders and indicates the rules and regulations that they should follow in order to successfully run a publicly listed company.

Corporate governance provides the structure through which the company's objectives are set, and the means of achieving these objectives and monitoring performance are determined (OECD, 2004,). Monitoring performance can expose the management's behaviour to shareholders, while incentives serve to align the management's interest with those of the shareholders to urge desired behaviour (Anderson, Melanson and Maly, 2007). OECD has worked extensively on corporate governance issues leading to the emergence of six principles. These principles enable companies to improve the standards and policies on the way they operate. The six principles are: 1) ensuring the basis for an effective corporate governance framework, 2) the rights of shareholders and key ownership functions, 3) the equitable treatment of shareholders, 4) the role of stakeholders in corporate governance, 5) disclosure and transparency and 6) the responsibilities of the Board (Lessambo, 2014, p.11).

From a scholarly perspective, corporate governance has predominantly been studied through an agency theory lens, with Jensen and Meckling (1976) being the first to suggest that managers are self-interested agents who act on behalf of the shareholders (principals). Their approach largely builds on earlier ideas by Berle and Means (1932) on the key problems associated with the separation of ownership and control. Agency theory argues that the conflicts of interest usually occur between an agent (manager) and the agent's principal (shareholder). The principal asks the agent to carry out a specific duty on behalf of their interests, although sometimes the agent may not act in the best interest of the principal and may prefer to pursue his/her own interests. The repercussions of this act/separation are the agency costs, and agency theory has been the main paradigm for understanding and explaining corporate governance (Rubach and Sebora, 2009).

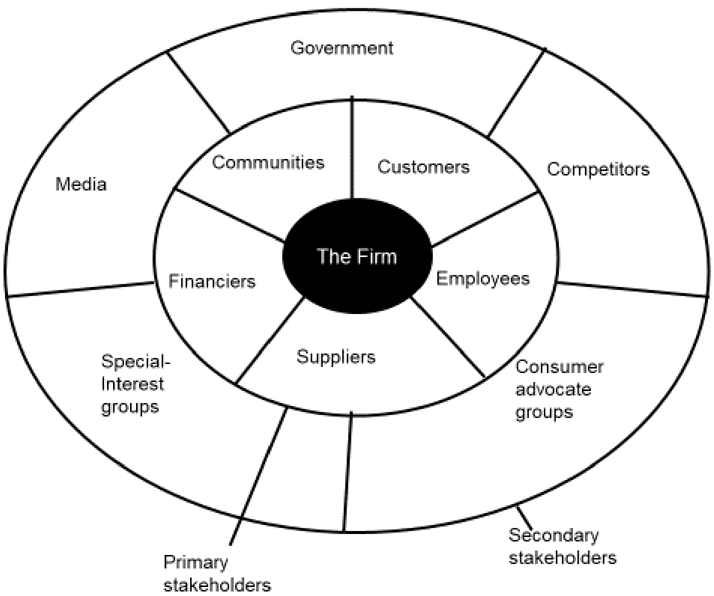
Since Jensen's and Meckling's use of agency theory, numerous studies (see comprehensive literature reviews by Dalton, Daily, Certo and Roengpitya (2003) and Dalton, Hill, Certo and Daily (2007)) have used this lens to explore and explain corporate governance issues and topics mainly focusing on: a company's financial performance and its relationship with Board structures and equity ownership; executive compensation; and the Board's contribution to strategy.

There have also been studies on corporate governance that have taken other theoretical perspectives. For example, there is a stream of studies (Dalton, Daily, Johnson and Ellstrand, 1999; Hillman, Cannella and Paetzold, 2000; Hillman and Dalziel, 2003) that use the theoretical foundation of resource dependence theory for evaluating directors' roles in providing access to resources needed by the company to enhance its functioning, performance, and survival. Other researchers have considered cognitive and behavioural approaches by studying the cognitive contribution of Board members and the impact of boardroom dynamics on strategic decision-making (Brundin and Nordqvist, 2008; McNulty and Pettigrew, 1999; Pye and Camm, 2003). Another group of researchers (Davis, Schoorman and Donaldson, 1997; Filatotchev and Nakajima, 2014; Van Puyvelde, Caers, Du Bois and Jegers, 2012) have used stewardship theory and stakeholder theory as a contrast (and complement) to agency theory and believe that managers frequently have similar interests to those of owners and/or shareholders and therefore, by protecting their interests, they will have to take certain decisions on their behalf.

Two main structures of corporate governance exist globally: i) the concentrated corporate structure and ii) the diluted corporate structure. Within the concentrated corporate structure, which is more common in countries such as Germany, France and Japan, a small group (family or a group of families) controls the company’s ownership and runs the company. This structure can offer stability in the long run as the family group that controls a company has fewer debates in decision-making processes. On the other hand, within the diluted structure, ownership and/or control is dispersed among shareholders. It is common in countries such as the United States (US) and the United Kingdom (UK), where most companies raise their capital by selling their shares in financial markets. As such, shareholders rely on the Board of Directors to manage the company and maximise its profits (Lessambo, 2014).

One of the most important goals of corporate governance is the protection of stakeholder interests (Garcia-Torea, Fernandez-Feijoo and De La Cuesta, 2016). These interests may be i) financial in the case of investors, ii) quality in the case of customers, iii) well-being in the case of employees and iv) environmental in the case of the community or activist groups. According to Mainardes, Alves and Raposo (2011), Pesqueux and Damak-Ayadi (2005) and Ranangen (2017) there are two stakeholder groups – primary and secondary stakeholders (see Figure 2.1).

Figure 2.1 The Basis Two-Tier Stakeholder Map



Source: Ranangen, H. (2017) Stakeholder Management Theory Meets CSR Practice in Swedish Mining. *Mineral Economics*, 30(1), pp. 15-29.

Primary stakeholders such as customers, suppliers, employees and shareholders have formal contractual relationships with the company. Ranangen (2017) argues that primary stakeholders are essential to the continuous growth and survival of any company. In contrast, secondary stakeholders are those without any contractual relationships, such as government authorities, the local community, activists and media. Secondary stakeholders can influence the primary relationships of a business; e.g., regulatory changes in the business environment can influence how shareholders such as shareholder activists conduct their practices in the market.

The emergence of stakeholder theory triggered the attention of scholars to look at stakeholders' interests and not only the shareholders of a company (Argandona, 1998; Gibson, 2000). Stakeholder interests are protected in the following ways: i) ensuring compliance with laws and regulations, ii) making sure of fair allocation of economic rents, iii) monitoring the decisions made by the company's management to ensure they will create long-term value for the company and iv) confirming the relevance and objective information prepared and provided by the company's management (Monks and Minow, 2008; Pergola and Joseph, 2011). The Board of Directors plays an important role in the governance of a company by protecting the above interests and ensuring that all practices followed by itself and the management are transparent.

2.1.2 Board of Directors

Research on the Boards of Directors is a vital area within the corporate governance discipline, because their main responsibility is to ensure that they govern a publicly listed company properly (Filatotchev and Boyd, 2009). It is nowadays more important to govern companies than manage them and some people fail to differentiate governance from management (Tricker, 2012b). Sir Adrian Cadbury's Report on the Financial Aspects of Corporate Governance (1992) describes the Boards of Directors' responsibility to govern their companies, whereas the shareholders' role is to appoint the directors and the auditors (Pergola and Joseph, 2011). Agrawal and Chadha (2005), Baysinger and Hoskisson (1990) and Garrat (1997) describe the Board's function as a collective responsibility that: i) determines the company's ethics and purpose, ii) decides about the company's overall business strategy, iii) plans, iv) monitors and controls the CEO and management and v) reports and makes recommendations.

The Board is an intermediary that must ensure the alignment between the managers' interests with those of shareholders and it is responsible for monitoring corporate managers and their performance (Gramm, 2015). Shareholders who are dissatisfied with the Board's performance have three choices: i) 'vote with their feet', e.g., sell their shares, ii) hold their shares and demonstrate their dissatisfaction, and iii) keep their shares and not react, also known as exit, voice and loyalty (Gillan and Starks, 2003).

The Boards of most publicly listed companies consist of inside and outside directors. 'Insiders' are officers or executives employed by the company, whereas 'outsiders' are executives of other companies (Wheelen and Hunger, 2010). Legislation demands from Boards' that they mainly have outside directors and audit committees within a company to have three independent directors (Pergola and Joseph, 2011). Empirical evidence shows that independent or outside directors are believed to be better able to monitor managers by protecting the interests of shareholders by requesting and evaluating past and current business information (Bonazzi and Islam, 2007; Brenner and Schwalbach, 2009). In addition, Boards that consist of more independent members have a lower occurrence of accounting fraud and earnings management (Agrawal and Chadha, 2005).

A country's government can influence the Board of Directors. For example, the court system (federal courts, state courts), regulation, enforcement bodies (SEC), lawmakers (federal and state legislation), and stock markets shape how companies organise and disclose their information. Furthermore, other influences include media such as business press (The Wall Street Journal, The Financial Times, Forbes, The Economist, and Fortune) as well as academics and think tanks. Finally, another group that can influence the Board includes auditors' (such as KPMG, PwC, Deloitte and Ernst & Young) who conduct audits on a company's financial statements, and proxy advisors such as Glass Lewis and ISS who advise a company on how to structure a proxy or advise a shareholder on how to vote.

McNulty (2013) points out that despite the efficiency of their governance arrangements there have been examples of Boards that were involved in cases of governance failures. Such failures were related to monitoring events and led researchers to propose that the problem's causes were the Boards' structure and the processes they followed (Anderson et al., 2007). Consequently, with more companies raising public funds, the US has developed a corporate governance structure based on a theoretical and legal principal-agent concept, despite the drawbacks and insufficiencies of such an approach (Lessambo, 2014).

2.1.3 Agency Theory

Most of the corporate governance literature has its roots in agency theory and links different governance aspects with a company's performance in order to minimise management conflicts and maximise shareholders' value (Filatotchev and Boyd, 2009). The conflicts can be even more complex as, despite the existence of gatekeepers such as independent auditors and rating agencies, corporate governance in the US has poorly delivered on its promises (Lessambo, 2014). Despite the above, most of the corporate governance research is based on the assumptions of agency theory, is quantitative in approach, and analyses US corporate databases or large companies (Pye, 2013).

Pirson and Lawrence (2010) claim that agency theory looks at corporate governance practices and behaviours through the agency dilemma lens and it is based on a reductionist perspective of a self-interested individual that must be monitored to enact management responsibilities for the shareholders' benefit. The theory views the governance relationship as a contract between shareholders (principals) and directors (agents) (Tricker, 2012b). The separation of ownership and control results in 'agency costs' for the principal, thus increasing the costs of controlling and monitoring (Cuevas-Rodriguez, Gomez-Mejia and Wiseman, 2012). Monitoring consists of regular reviews of management prerequisites, financial audits, and placing limitations on management decision-making (Bonazzi and Islam, 2007). Hedge fund activism as the main area of investigation in this study is an actual form of external monitoring (Muhtaseb and Grover, 2012).

There have been critics of the agency theory approach who have characterised it as narrow, as it does not take into consideration other stakeholders' views that may indicate different interests among shareholders (Filatotchev and Boyd, 2009). Cuevas-Rodriguez et al. (2012) argue that agency theory does not acknowledge the social context in which the principal-agent contract takes place and how that context can affect both the interests and mechanisms for aligning the interests of principals and agents. In addition, Eisenhardt (1989) criticises agency theory for presenting the partial view that, although it is valid, it disregards part of an organisation's complexity. Corporate governance and agency theory are associated with the theoretical framework of shareholder activism (Lantz, Montandrau and Sahut 2010).

2.2 Shareholder Activism

The phenomenon of shareholder activism is not new in the corporate landscape and over the years it has evolved to a political model of corporate governance that has been the result of targeting corporate governance performance (Goranova and Ryan, 2014). Dating back to the late 1970s, and throughout the 1980s, known as the 'Deal Decade', shareholder activists were known as 'corporate raiders', 'bust-up artists' and 'greenmailers' (Nathan, 2013). Shareholder activists have been characterised by The Economist (2015) as the 'jackals of capitalism' and 'outcasts' who, despite extensive disapproval in the past, attack weak companies. Often criticised as being short-term shareholders who buy stakes in companies and demand money, or some type of settlement, they have rebranded themselves as 'constructive activists' or 'highly engaged shareholders' (Fortado, 2018).

Within the last 20 years, institutional investors and other groups have engaged in all forms of shareholder activism, also known as ‘relationship investing’ (Dai, 2013; Gillan and Starks, 2000). During the 20th century, the ownership pattern continued to change and in countries such as the US and the UK it led to the increase of institutional share ownership (Malin, 2013). This increase is addressed by Gillan and Starks (2003) who refer to the evolution of shareholder activism in the US and the growth of investment from 6.1% of institutional share ownership in 1950 to over 50% by 2002. Since the 2000s, shareholder activism has been an established corporate governance mechanism and received an increased interest from activist hedge funds and other shareholder activists who are able to influence corporate governance in organisations with small stakes (Katelouzou, 2015).

A report by the Boston Consulting Group presented the global increase in institutional ownership and showed that the assets managed by shareholder activists had increased over 2004-2014, from $12 billion to $85 billion. Since 2005, the number of activist campaigns in the US has increased 15% per year, reaching 144 campaigns in 2012 (Hammoud, Shandal, Hansell and Roos, 2014). Additionally, from 2013 to 2019 the number of companies that were publicly subjected to shareholder activist demands worldwide had grown from 609 to 839 respectively, although the number of demands fell to a four-year low (Activist Insight, 2017; Activist Insight, 2020).

Well-known corporations such as the Boston Consulting Group, Deloitte, J.P. Morgan, McKinsey & Company and PricewaterhouseCoopers as well as a vast array of media sources such as Activist Insight (industry media and data company), Bloomberg Business, The Wall Street Journal and The Economist have published articles and reports that address the impact of shareholder activism in financial markets. The growth of shareholder activism is evident nowadays when leading CFOs admit that activist threats are '*now what keeps them awake at night*'. It is also evident when activist interventions at corporations in excess of more than $100 million had grown nearly fourfold over the three-year period 2012-2015 (Foldesy, Hansell, Friedman, Janda, Kotzen and Hammoud, 2015). As a result, it is of no surprise that shareholder activism is regarded as the biggest concern in America's boardrooms (The Economist, 2015).

However, shareholder activism also grows in markets outside the US where shareholder activists pursue higher investment returns and less competition within the US market (Flaherty and Cruise, 2015). Although the European market may be attractive for activists, it provides challenges for them as it is smaller compared to the US market and hedge fund activists in the region face difficulties when intervening in companies (Kutay, 2014; Marriage, 2013). Bill Ackman from Pershing Square, a well-known US activist hedge fund declared in a conference in Oxford, UK, that Europe was 10 years behind the US in terms of the degree of shareholder activism and in terms of how Boards of Directors respond to activists (Foley, 2015). However, at the same conference, Ackman announced that shareholder activism '*is going to happen*' in Europe. Ackman's statement followed rumours that Pershing Square was raising money for a fund that could possibly list in the London Stock Exchange (LSE) on the summer of 2014, a listing that came to fruition when, in May 2017, his fund made its debut on the LSE (McCrum, 2017; Thind, 2014).

2.2.1 The Nature of Shareholder Activism

Shareholder activism is not a homogenous practice. It comes in various forms, different actors and agendas drive it and its impact is different depending on the target (Adegbite, Amaeshi and Amao, 2012). Several definitions demonstrate its relationship with the corporate governance of companies with one of them by Judge et al. (2010, p.260) defining it as '*the use of ownership to actively influence company policy and practise*'. The main intention of shareholder activists is to shake up the Boards of publicly listed companies that look attractive to their investments. They primarily focus on poorly performing companies and pressure their management to improve their performance in order to increase shareholder value (Gillan and Starks, 2000; Jiang and Anandarajan, 2009). Shareholder activists usually invest in companies that are undervalued and demand changes such as higher dividends, share buybacks, cost effective practices, management changes, and sometimes the break-up of companies (Lachapelle and Jinks, 2014). Other tactics that they adopt include Board restructuring, the restriction of executive compensation and confidential voting (Martin and Nisar, 2007). Consequently, the continuous and increased interest of shareholder activists in publicly listed companies is the result of identifying certain vulnerabilities within their Boards.

Croci (2007) argues that the media have mixed feelings about shareholder activists, because they are only interested in short-term investment returns. Although their short-term interest may be damaging for Boards and may disadvantage long-term investors, advocates believe that all shareholders could benefit from an increasing share price (Tricker, 2012b). The Head of the US Securities and Exchange Commission (SEC) believes that shareholder activists may be a force for good by making improvements in how public companies run (The Economist, 2014). However, the management of many publicly listed companies believe that activists lack the expertise to understand their targets and view activism as a threat to their jobs or independence. Even US Presidential contender Hilary Clinton has criticised them as '*hit-and-run activists whose goal is to force an immediate payout'* (Sorkin, 2015). Consequently, the aim and the form of activism varies, as it ranges from cooperative to hostile represented by hedge funds (Ghahramani, 2013; Ryan and Schneider, 2002).

2.2.2 Hedge Funds as Shareholder Activists

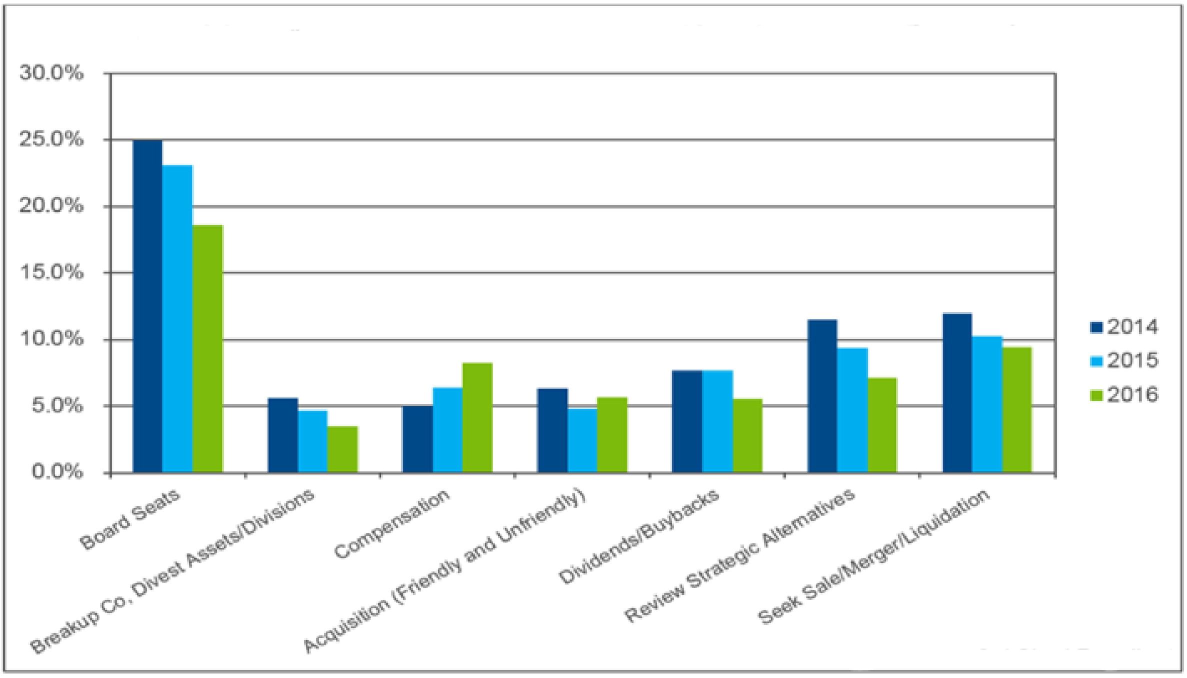
Hedge funds have emerged as aggressive shareholder activists at corporate markets pursuing offensive shareholder activism that is primarily performance-driven activism (Bratton, 2010; Cheffins and Armour, 2011). Their hostile engagements can be disruptive for companies and as Damien Park, founding and managing partner of Hedge Fund Solutions, states, '*it wreaks havoc*'. Nevertheless, they are a small proportion of the hedge fund industry. In 2015, of a total number of 8,000 hedge funds, activists numbered only 71, less than 1%, and they were larger than most as they managed $120 billion (The Economist, 2015).

Under pressure to perform in the aftermath of the 2007-2008 global financial crisis, hedge funds have turned to shareholder activism as a way to maximise their profits and increase their returns on investment, looking to influence corporate policies and hold the management of underperforming companies accountable (Hilldrup, 2013). Consequently, they became a leading force in the shareholder activism industry and an increasing number of them increased their share in their investments (Zur, 2008).

Not surprisingly, The Wall Street Journal calls them the ‘new leader’ on the list of activists attacking corporate boards (Dai, 2013).

Activist hedge funds aim to achieve four things in their targets: 1) potential sale of the company, 2) potential sale of a company’s parts, 3) free cash and 4) reducing a company’s operating costs. Additionally, they may propose that a target company change their investment or payout levels, alter their capital structures and/or replace their CEO (Bebchuk et al., 2015). Figure 2.2 illustrates the top value and governance demands by shareholder activists during the period 2014-2016. During this period, activists focused on acquiring Board seats, seeking sale or merging their targets and reviewing strategic alternatives. Acquiring Board seats enables activists to exert significant pressure on their targets, as they are likely to influence the views of Board members and investors. Their presence on a company’s Board may allow them to achieve the financial gains they seek from their investment.

Figure 2.2 Total Activist Demands 2014-2016 (% of Total Demands)



Source: Birstingl, A. (2016) 2016 Shareholder Activism Trends. Available at: https://insight.factset.com/2016-shareholder-activism-trends [Accessed: 18 March 2017].

Hedge fund activism has been related to high rates of organisational change, as 60% of the campaigns are successful in obtaining significant changes in a company (Klein and Zur, 2009). Moreover, hedge fund activists increase the Board's size in 76% of their targets, they obtain Board representation in 69% of their targets, and promote mergers in 66% of the targets (Boyson and Mooradian, 2011).

Although there is not one accepted definition of the term 'hedge fund', the SEC (2003) defines it as:

> *'an entity that holds a pool of securities and perhaps other assets, whose interests are not sold in a registered public offering and which is not registered as an investment company under the Investment Company Act'.*

Brav, Jiang, Partnoy and Thomas (2008) argue that hedge funds usually display four characteristics: 1) they are private investment companies, 2) they are run by investment managers with performance-based incentives who may have invested in the fund, 3) they are not available to the public and 4) they operate outside of regulations and registration requirements. Therefore, they are attractive investment companies for wealthy investors who want to benefit in the short-term and can operate flexibly in the financial markets.

Hedge funds act as a vehicle, helping investors to turn opportunities into investment returns and are subject to fewer restrictions compared to other institutional investors (Boss, Connelly, Hoskisson and Tihanyi, 2013; Nicholas, 1999). Their structure differs from that of other institutional investors. Their manager's ability to earn performance-based pay and lock-up capital investment may increase their incentives to monitor and influence their targets (Clifford, 2008). Dai (2003) compares them to pension funds and argues that hedge funds are not subject to extensive public influence, or political control. Compared to other types of engaged investors, hedge funds have important three advantages for investors:

1. They usually charge investors a fixed annual fee of two per cent of their investments and a twenty per cent performance fee based on the fund's annual return.
2. They typically lock-up investor capital for six months, although some request lock-up of capital for two years or longer. As a result, hedge funds' shorter lock-up durations with their large, illiquid positions, usually invite aggression and impatience.

3. They are not regulated, and they typically suffer fewer conflicts of interest than managers at other institutions. These factors give hedge fund managers more freedom to engage in shareholder activism than other institutional investors (Brav et al., 2008; Bratton, 2010).

The investments of activist hedge funds are not random, but they are the result of systematic research on their targets. Brav et al. (2008) argue that they tend to aim at companies that are 'value' firms with low market value compared to book value, although they are profitable with sound operating cash flows and pay their CEOs more than their peer companies before their interventions. Boyson and Mooradian (2012) also stress that their targets have also worse operating performance, lower sales, smaller size, and higher expenses in the year prior to the attack. Furthermore, they tend to target companies whose stock prices have slowed down compared to those of competitors (Greenwood and Schor, 2009; Muhtaseb and Grover, 2012).

Each hedge fund's approach may be different. They may ask their targets to consider alternatives such as financial restructuring or selling a business unit or the entire company for a premium (Muhtaseb and Grover, 2012). They do not always aim to control their targets. Instead, they depend on management cooperation or, in its absence, support from other shareholders to promote their agendas (Dai, 2013). For example, when a company's management implements minimum changes, activists will usually soften their approach; however, if they resist, the activists will employ a hostile approach (Kruse and Suzuki, 2012).

From a regulatory perspective, activist hedge funds must comply with general rules that seek to protect investors. Hilldrup (2013) and Zur (2008) point out that these include disclosure requirements under Section 13(d) of the Securities Exchange Act of 1934. The Act requires public disclosure by individuals who own more than 5% of the shares of a publicly listed company within ten days of acquiring the shares (Brav et al., 2008; Levin and Masterson, 2006). Hedge funds generally seek to exceed that level of ownership for two reasons: 1) Schedule 13D filings generate media interest and publicity and 2) the act of filing, and the potential legal liability associated with any disclosures made, support a hedge fund's trustworthiness with investors (Brav et al., 2008). In contrast, there are also hedge funds that do not exceed the 5% threshold because, by disclosing their ownership, they expose themselves and the plans they have for their targets (Levine, 2015).

Research evidence suggests that hedge fund activism creates value. Activist interventions follow a decrease of about $1 million on CEO pay, CEO turnover goes up by 10% and their interventions usually generate improved shareholder returns (Cheffins and Armour, 2011; Gantchev et al., 2017). By reducing agency costs through the reduction of excess cash and overpay to CEOs, it increases payouts, improves operating performance and tends to increase share prices (Dai, 2013; Levine, 2015). Nevertheless, it is not appropriate to judge activism based on only share performance. Many interventions may result in a company's sale resulting in positive share returns; however, the impact of a sale on long-term shareholders is unclear. Shareholders will usually benefit if hostile activism separates underperforming managers from a valuable business (Gramm, 2015).

Critics of hedge fund activists have claimed that their actions overall or on average decrease the organisation's value in the long term even if they are profitable in the short term. Other critics refer to the pressure they exert on their targets to reduce research and development expenses and capital expenditures because they promise to pay off only in the long term (Bebchuk et al., 2015). Despite academic research that supports the effectiveness of activism, target companies do not usually embrace the advent of activists in their companies, as it is costly to deal with them, it can be time consuming and can lead to disruptive operating changes (Boyson and Pichler, 2017).

During the period 1994-2005, a sample including 418 separate activist events involving 111 hedge funds and 397 target companies, demonstrated that the average activism period was slightly over two years in length (Boyson and Mooradian, 2011). However, a hedge fund activist usually owns shares in a company for almost a year. The most patient activists will own a company's shares for a sufficiently long period – SEC rules prescribe three years to benefit from proxy access – (Cheffins and Armour, 2011). Running proxy fights and serving on Boards can tie up capital leading to inconsistencies between the duration of the fund's investment and liquidity terms. Many hedge funds will inform their investors about their long-term commitment, but this will not occur if their performance becomes weak (Gramm, 2015).

Over the years, changes in the regulatory environment have enabled hedge funds to grow and attack publicly listed companies. The increase in institutional shareholding of companies forced the US government to implement regulatory changes that benefited the evolution of hedge funds. In 1985, Robert Monks set up Institutional Shareholder Services (ISS), the first proxy advisory firm and in 1988, proxy voting was established as a fiduciary duty of pension funds. In 2003, proxy voting was also applied to all institutional investors including hedge funds. In 1992 and 1999, the second set of regulatory changes (proxy rule changes) allowed shareholders and the management of publicly listed companies to communicate and engage. Shareholder activists could publicly criticise a company's management if their statements were false. Finally, the 1996 National Securities Markets Improvement Act allowed hedge funds to generate resources from institutional investors without requiring disclosure of their structures. This regulatory change allowed co-investments between activist hedge funds and institutional investors who invested in hedge funds as 'alternative investment' (Shin, 2018). Consequently, their evolution and their importance in the corporate landscape has led researchers to a new stream of research focusing on hedge fund activism (Bratton, 2010; Brav et al., 2008; Briggs, 2007; Clifford, 2008; Greenwood and Schor, 2009; Katelouzou, 2015; Klein and Zur, 2009).

Hedge funds are different compared to other institutional investors in the form of the intervention – defensive and offensive – they employ. 'Defensive' shareholder activism occurs when an investor becomes dissatisfied with the company's corporate performance or governance and reacts by seeking change, whether by negotiating directly with the management or engaging publicly, such as through a public contest. Mutual funds and pension funds usually pursue this type of activism by becoming active in order to protect their investments. On the other side, 'offensive' shareholder activism appeals to investors, such as hedge funds, that pursue activism as a profit-making strategy. Hedge fund managers first determine whether a company would benefit from activism, then take a position and become active (Cheffins and Armour, 2011).

Since strategic activism is expensive, it requires a hedge fund to invest heavily in a few companies, anticipating that the benefits derived will outweigh the costs (Armour and Cheffins, 2009). An offensive activist is usually responsible for all the costs associated with the intervention while receiving a return proportional to its stake in the company (Hilldrup, 2013). However, there is a belief that hedge fund activism is not always hostile. In their study, Brav et al. (2015) characterise only 30% of hedge fund interventions as ‘openly hostile’, requiring an actual or threatened proxy contest, a takeover threat, litigation, or public statements. This mode of engagement, note the authors, forms part of their tactics to influence investors, stakeholders and the investment community.

Greenwood and Schor (2009) and Pearson and Altman (2006) suggest that an activist’s demands fall into nine categories: 1) engage with the management because of the share’s low value, 2) capital structure issues, 3) corporate governance issues, 4) business strategy issues, 5) ‘strategic alternatives’, 6) demanding the sale or part of the company, 7) blocking a proposed merger or acquisition because of unfavourable pricing, 8) financing for a firm in distress, or other bankruptcy-related issues and 9) the intention to engage in a proxy contest.

Cheffins and Armour (2011) note that a hedge fund’s strategy will depend on their target, although hedge funds usually aim to challenge management to adopt financial changes. Proactive hedge fund activists initially contact management with a phone call, e-mail or letter, urging them to agree to implement their proposal designed to increase shareholder value. Following the initial contact, hedge funds usually focus on exerting pressure on a company by demanding changes. If their interventions are successful, hedge funds will increase the balance sheet of companies by demanding the sale of non-core assets or a change in management if the company is underperforming (Armour and Cheffins, 2009). In situations where the company has excessive cash resources, they will pressure the company to engage in stock repurchases or return dividends to their shareholders (Kahan and Rock, 2009). In addition, when the company has assets such as real estate, they lobby to monetise those assets (Cheffins and Armour, 2011).

One of the tactics of hedge fund activists is running proxy contests to gain seats on the Board of Directors when they are unable to influence management decisions. Proxy fights can challenge the corporate governance of an organisation as shareholder activists publicly contest against their targets. According to Goldberg and Nathan (2017), proxy fights are distractive and expensive and the average median cost of defending against an activist has doubled in the last five years. A proxy fight is a crisis and a crisis response team should be in place, including legal counsels, investment bankers, proxy solicitors and communications specialists to assist management in engaging with the activist (Nathan, 2013). Previous successes of activists have even made the most confident CEO’s engage with them leading to settlements either before or after a proxy contest (Goldberg and Nathan, 2017).

2.2.3 Hedge Fund Activism Research

Hedge fund activism has been researched extensively over the last 15 years and it is based on assumptions of agency theory. Scholars have examined numerous hedge fund campaigns that occurred in the past and included hedge fund interventions in publicly listed companies. Table 2.1 presents an overview of these studies including the sample, data collection techniques, data analysis techniques and the findings in each case.

Table 2.1 Hedge Fund Activism Research

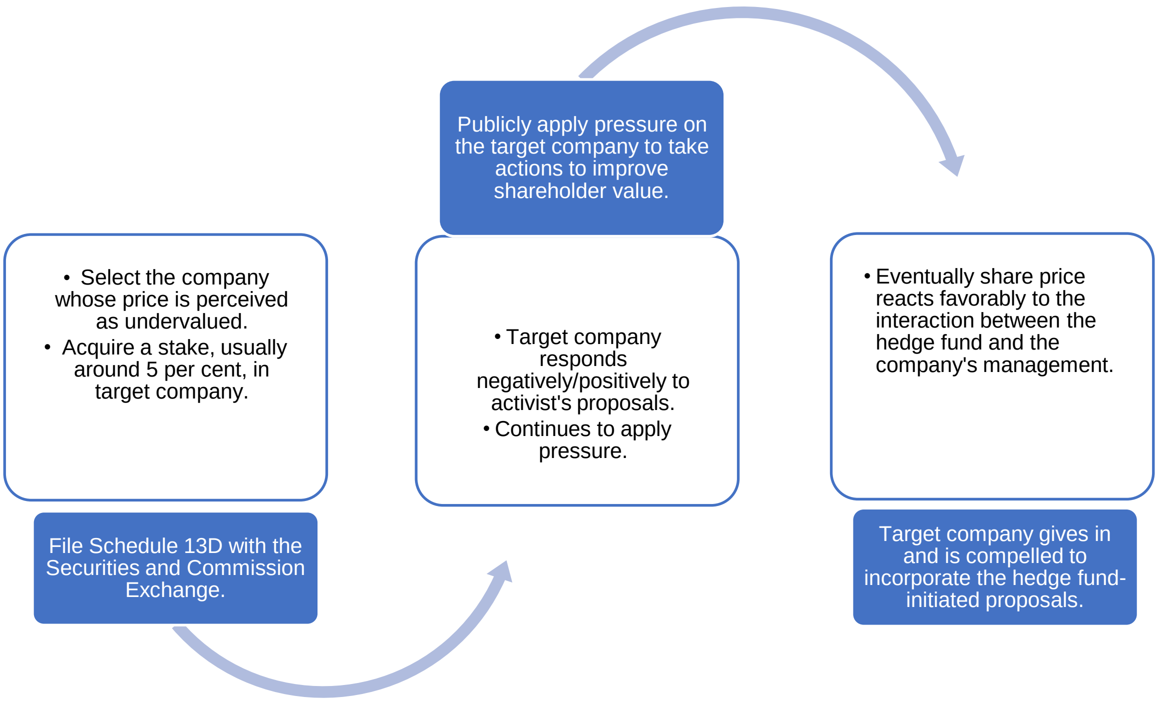
Author	Sample	Data Collection	Data Analysis Technique	Findings
Agrawal and Chadha (2005)	159 U.S. public companies.	Hand-collected dataset	Descriptive statistics	Governance characteristics are unrelated to the probability of a company restating earnings.
Klein and Zur (2006)	194 13D filings between 1 January, 2003 and 31 December, 2005.	Hand-collected dataset	Univariate analysis, logistic models, sensitivity analysis	Target companies earn significantly higher abnormal stock returns around the initial 13D filing date than a sample of control company.
Croci (2007)	136 block purchases by 15 shareholder activists during the period January 1990 to December 2001.	National daily newspapers in Europe.	Calendar-time portfolio regression, event study analysis	A positive market reaction to the first public announcement of purchases. In the long-run, activists earn an abnormal profit when they sell their stakes.
Donaldson and Davis (2007)	321 U.S. companies	Compensation survey based upon data drawn from S&P.	Mean comparison analysis	Shareholder returns, in terms of ROE, are superior when there is CEO duality.
Brav et al (2008)	236 hedge funds and their 1,059 events involving 882 target companies between 1993 and 2006.	Hand-collected dataset	Descriptive statistics, calendar-time portfolio regressions	U.S. activist hedge funds propose strategic, operational, and financial remedies and attain success or partial success in two-thirds of the cases.
Zur (2008)	Activism campaigns by 117 hedge funds that engaged in 695 active investments during the years 1994 to 2006.	Hand-collected dataset	Descriptive statistics	Schedule 13D announcement premium is significantly higher when the target firm's prior stock price performance and level of cash are positive.
Brenner and Schwalbach (2009)	27 developed and some developing countries observed over the period of 1995 to 2005, encompassing 216 observations.	Remuneration data that are provided by a US consulting company.	Panel Data Analysis	Independent of managerial risk-aversion, CEO pay is always less generous under stricter anti-director rules and a stronger rule of law.
Greenwood and Schor (2009)	20,771 Schedule 13D and DFAN filings between 1993 and 2006.	Hand-collected dataset	Calendar time portfolio regressions	Abnormal returns surrounding investor activism are high for the subset of targets that are acquired ex-post.
Pergola and Joseph (2011)	499 publicly traded companies.	A governance index was calculated and the relative power of equity ownership and governance was regressed on reported earnings quality.	Statistical methods	Both independent and insider board members become entrenched, negatively impacting reported earnings quality and the strength of the governance structure.
Boyson and Mooradian (2012)	269 activist events from 1994 to 2005.	Hand-collected dataset	OLS and quantile regressions	Targets of experienced hedge fund activists earn higher long-term stock returns than targets of less experienced activists.
Bebchuk et al (2015)	2,000 interventions by activist hedge funds during the period 1994-2007.	Hand-collected dataset	Regression analysis, calendar-time portfolio regressions	No evidence were found that interventions are followed by declines in operating performance in the long term. Activist interventions are followed by improved operating performance during the five-year period following the intervention.
Katelouzou (2015)	432 activist hedge fund campaigns during the period of 2000-2010 across 25 countries.	The Dow Jones Factiva and regulatory filings for the countries whose filings are available in Factiva.	T-test statistics, Mann-Whitney U-test statistics and chi–square test.	Mandatory disclosure and rights bestowed on shareholders by corporate law are found to dictate how commonplace hedge fund activism will be in a particular country.
Boyson et al (2016)	1,899 activism campaigns over 2000-2012 and a merger sample of 3,357 transactions over 2000-2014.	Hand-collected dataset	Capital asset pricing model, regression analysis, descriptive statistics	Activism is associated with a substantially higher probability of subsequent merger activity and that this effect is driven by the intensity of the activists' engagement with management and their prior experience in activism mergers.
Boyson and Pichler (2017)	Hedge fund activist campaigns for the period 2001-2012; about 1,200 activism campaigns.	Data comes from Shark Repellant. The data is supplemented with hand-collected data from SC-13D filings.	Regression analysis	The stock market responds unfavorably to resistance, reducing the initial positive stock market reaction to activism for cases in which hedge funds do not counter-resist.
Gantchev et al (2017)	1,034 hedge fund activist campaigns between 2000 and 2011.	Hand-collected dataset	Descriptive statistics	Peers with fundamentals similar to those of previous targets feel threatened by activism activity in their industry and respond by reducing agency costs and improving operating performance in the same way as the targets.

These studies consist of large samples of activist hedge funds interventions that have been collected primarily by Schedule 13D filings and data available on hedge funds from financial data companies. In addition, scholars have focused on formal quantitative accounts based on accounting data such as monthly net-of-fee returns. In view of previous research, there is a need to focus on an approach which enables an understanding of the complexity of organisations and the Board's interactions with shareholder activists and other stakeholders rather than only focus on financial outcomes.

2.2.4 Activist Hedge Fund Tactics

Figure 2.3 presents the tactics that an activist hedge fund implements when it aims to intervene on the Board of a publicly listed company.

Figure 2.3 The Tactics of an Activist Hedge Fund



Source: Muhtaseb M.R. & Grover K.K. (2012) Hedge Fund Activism: Cases, Analysis and Corporate Governance, *International Journal of Disclosure and Governance*, Vol. 9, No. 3, pp. 264-283.

Activist hedge funds adopt certain tactics during their intervention in the target company. After identifying a company's vulnerability/ies, they will usually take a position in their target and file their share acquisition with the SEC. Once they have completed the accumulation of shares, the intervention begins with the activist having private discussions (telephone call, letter or e-mail) with the target's Board. Target companies frequently engage in private negotiations with activist hedge funds. These negotiations are an essential component of the activism process, and they usually result in some form of compromise between activists and target companies (Boyson and Pichler, 2017). If a private negotiation fails, an activist hedge fund will intensify the pressure by criticising the company publicly or by threatening a lawsuit against the Board (Cheffins and Armour, 2011).

Pressure by shareholder activists may lead the incumbent Board to adopt certain governance mechanisms such as poison pills and staggered boards. Corporate boards may sometimes adopt poison pills (also known as Shareholders Rights Plans) in response to shareholders who seek to gain control. The poison pill is a form of defence tactic that makes it very costly to acquire control of a target company (Lu, 2016). Poison pills are usually triggered when the company receives a hostile offer to acquire shares from shareholders at a specified price, typically at a significant premium to market price (Hilldrup, 2013). It attaches dormant rights to each share of a company's stock and these rights are activated when an investor acquires a certain percentage of a company's outstanding shares, usually 15%-20%.

Even after the adoption of a governance mechanism, a shareholder activist may continue to apply pressure by protesting publicly to attract media attention. Activists adopt sophisticated public relations, social media and traditional media campaigns to demonstrate their arguments (WLRK, 2019). Sometimes activists may release a presentation to the public and to investors where they present their views about their target. In this case, an activist's public protest may increase the share price of the target company, thus, benefiting the company, the activist and other shareholders. In the event of no financial gains, the target company may seek to settle their debate with the activist and consider their demand for changes (WLRK, 2019).

2.3 Corporate Governance and Complexity Theory

The relationship between the Board and the stakeholders of a company's corporate governance ecosystem contribute to the growing complexity of the target company. Agency theory has been popular in corporate governance research and offers a convincing justification for the survival and even the prosperity of a publicly listed company (Daily, Dalton and Cannella, 2003). In the relevant literature, good corporate governance provides all the mechanisms that can deter this managerial self-interest. However, it is the very simplicity of this theory and the reductionist ('cause-and-effect') approach it takes that has instigated a call by scholars (Daily et al, 2003; Hambrick, Von Werder and Zajac, 2008; Huse, Hoskisson, Zattoni and Vigano, 2011) to move beyond its almost exclusive use, to pursue broader conceptualisations of corporate governance.

Goergen et al. (2010) have argued that agency theory as an analytical framework cannot capture the Board's complexity and can only focus on one aspect of the corporate governance ecosystem such as the financial framework. Complexity theory offers a new imagery and a vocabulary that enables researchers to pursue more meaningful, open-ended, and systemic modes of inquiry (Prigogine, 1997). In this way, Boards dynamics may be understood as dynamic systems operating within complex political, economic, sociocultural, technological and legal environments. In other words, complexity theory studies social systems comprehensively by looking at the multiple, interacting dimensions that together create the social ecosystem (Goergen et al., 2010). With this new imagery and vocabulary, complexity theory raises an awareness of dynamic processes, unpredictability, novelty and emergence, leading to what Kellert (1993, p. 114) calls ‘dynamic understanding’.

Goergen et al. (2010) stressed the relationship of corporate governance and complexity by viewing corporate governance as a complex social system with specific inter-related characteristics. In this study, a complex social system is the Board of Directors that has its own agenda and supports a specific function of the system (shareholder interests). However, while complexity theory has the potential for being a very powerful tool to further the study of corporate governance, the literature on corporate governance using complexity theory is still very limited and none of the existing studies use more than a few complexity principles in their analysis (Goergen et al., 2010). The application of complexity theory also has limited application in the hospitality and tourism industries. There are studies that focus on concepts such as the happiness of frontline service employees in the hospitality industry (Hsiao, Jaw, Huan and Woodside, 2015), on complex and chaotic tourism systems (Baggio and Sainaghi, 2011) and on customers’ purchasing intentions in peer-to-peer accommodation (Pappas, 2017).

Despite the limited use of complexity theory to corporate governance studies, there is a growing application of complexity principles and models applied in healthcare studies and in military studies. For example, there are studies that have addressed complexity in health care (Begun, Zimmerman and Dooley, 2003; Edgren and Barnard, 2012; McDaniel and Driebe, 2001; Plsek and Greenhalgh, 2001), in health systems (Caffrey, Wolfe and McKevitt, 2016), in emergency departments (Smith and Feied, 1999), in health care research (Kernick, 2006) and in health care leadership (Zimmerman, Lindberg and Plsek, 1998). In addition, there are military studies that have addressed complexity in areas such as war zones (Blakesley, 2005; Hendrick, 2009; Moffat, 2003).

Extending complexity theory to the notion of corporate governance is appropriate, as increased complexity not only affects managers but also Board members (Pirson and Turnbull, 2012). However, the literature applying complexity theory to corporate governance has two major weaknesses. One is that most authors focus on one or very few complexity principles, whereas the other is that most of the work reported is theoretical rather than practical (Goergen et al., 2010). In both cases, this study will i) fill the gap by applying several complexity principles and ii) analyse the findings focusing on real life events.

2.4 Summary

The review of the literature in this chapter has identified and discussed one of the main subject areas in this study, corporate governance. In this chapter, shareholder activism and the Board of Directors have been reviewed and analysed as important corporate governance mechanisms. Research into shareholder activism has indicated that changing ownership patterns throughout the 20th century have led to the growth of the phenomenon evidenced in the number of activist campaigns, assets managed by shareholder activists and the number of companies that were publicly subjected to shareholder activists' demands. Over the last decade, hedge funds are the driving and leading force in '*offensive*' shareholder activism and their engagements are highly disruptive for a target company. The review of shareholder activism concludes that the phenomenon is relevant for hedge funds which aim to drive changes, and this is achieved by following several steps when targeting the Board of a publicly listed company.

Although shareholder activism is an important corporate governance mechanism, the Board of Directors represents the most important area within corporate governance research. The subject areas of corporate governance and shareholder activism are strongly associated with agency theory and have been employed extensively in the relevant academic research. Agency theory looks at corporate governance practices and behaviours through the lens of the agency dilemma; it is based on a reductionist approach and it only presents a partial view of the world that ignores the complexity of organisations.

CHAPTER THREE - COMPLEXITY THEORY

3.1 Complexity Theory

It is widely accepted that complexity theory represents a recognition of the limitations of the Newtonian linear approach when applied to complex systems (Hendrick, 2009). Newtonian thinking views the world as a machine that is based on simple principles and several disciplines such as biology, psychology and economics have adopted this view. It remains valid if someone can predict an eclipse involving the planets (Grobman, 2005). However, this perspective does not work for many aspects of human behaviour that are representative of human systems such as organisations (Zimmerman et al., 1998). Newtonian thinking is based on the assumptions of: i) linearity and proportionality of cause and effect (small inputs have small effects, large inputs have large effects), ii) the whole being the sum of its parts (reductionism), iii) the belief in a possible prediction having perfect measurements, iv) impartiality – an individual can be outside the system without being influenced by it and v) the idea that the natural state of the system is in equilibrium (Blakesley, 2005; Kernick, 2004).

These assumptions are characteristics of complicated systems, where there may be various interacting parts, for example, wiring in an aircraft. However, no amount of studying the parts will allow us to predict what will happen in the system, indicating that linear thinking is often superficial and simplistic (Hendrick, 2009). On the other hand, nonlinear thinking is more sophisticated and often requires someone to spend a little more time thinking, and a little less time working (Richardson, 2008).

Johnson (2007) argues that complexity theory focuses on the emergence of new phenomena from the collection of components that interact in a simple way but may lead to a rich variety of outcomes. These components, according to Burnes (2005), are non-linear systems that are at the edge of chaos, systems that are constantly changing and lead to the emergence of new order. Complexity theory also addresses aspects of living systems that are neglected or understated in traditional approaches (Chadwick, 2010). Within the aspect of living systems, complexity allows researchers to look at problems from numerous perspectives, by studying the micro and macro issues and understanding how they are interdependent (Zimmerman et al., 1998).

Burnes (2005) notes that academics and practitioners are increasingly seeing complexity theories as a way of understanding changing and complex organisations. The world is seen as a complex system (a network of elements that interact with each other and their environment) that is non-linear (there is not a straightforward relationship between cause and effect and non-linear systems are unpredictable) and dynamic (changing continually with time and influenced by what has happened before) (Burnes, 2005; Kernick, 2004) or the system is always in a state of change, leading to emergent order (Black, 2000). The order discovered by complexity theorists is alleged to be 'emergent' as it integrally depends on the use of a level of description to capture the behaviour of the system that is not obscured by one's efforts to comprehend (McIntyre, 1997, p. 2).

Complex systems have elements that exchange information in such a way that a change in the context of one element changes the context for all others, but it is the interdependencies and interactions among the elements that create the whole

(Anderson, Crabtree, Steele and McDaniel, 2005). In a company, the interactions between the Board, shareholders and other stakeholders often may result in tensions and can create a complex environment that can lead to uncertainty and unpredictability. The uncertainty and unpredictability then lead to a future that is unknown, as emergent properties cannot be predicted from the system's individual parts due to the non-linear interactions. Therefore, we can never be certain what the result of any intervention of shift will be (Begun et al, 2003; Boulton, Allen and Bowman, 2015).

Complexity theory studies social systems holistically. It looks at all related elements or all corporate governance agents that interact and influence each other, within the entire corporate governance environment of the social ecosystem (Mitleton-Kelly, 2011). The use of complexity as a metaphor may offer interesting insights into the way that companies operate. This leads to an argument suggesting that complexity does not offer companies a picture of 'what is' or 'what will be' but instead of 'what might be' (Burnes, 2005). Therefore, complexity looks at the behaviour of complex systems – this is the intention of this study – rather than how they should behave (Zimmerman et al, 1998).

3.1.1 Complexity Theory Research

Complexity theory is identified as providing a new perspective and a new method of theorising that can be practiced by disciplines within the social sciences (Turner and Baker, 2019). Previous studies have adopted complexity theory as a framework and used its extensive language to understand organisational practices and processes among different disciplines such as education studies, organisational studies, military studies and health care studies. Table 3.1 presents an overview of previous studies that include the sample, data collection techniques and the findings in each case. These studies comprise relatively small samples of companies that are used as cases and data that have been collected by interviews, observations and secondary data methods. Considering previous research in corporate governance studies and hedge fund activism studies, there is a need to focus on an approach that will challenge traditional approaches (reductionism) such as agency theory that these studies have adopted.

Table 3.1 Complexity Theory Research

Author	Sample	Data Collection	Findings
Smith and Stacey (1997)	An international agency	Case study	International organizations need to support adaptiveness in action, using an informal cooperative networking approach, which implies a new type of governance.
Mitleton-Kelly (2003)	An international bank	Case study - primary research	The complexity approach to managing is one of fostering, of creating enabling conditions of recognising that excessive control and intervention can be counterproductive. When enabling conditions permit an organisation to explore its space of possibilities, the organisation can take risks and try new ideas.
Paraskevas (2006)	A hotel chain	Case study - interviews and secondary data analysis	Identifications of weaknesses in the chain's crisis response and complexity theory provided a good theoretical foundation of the proposals to overcome them.
Mason (2007)	2 companies in the IT and packaging industries.	Interviews and document analysis	More successful companies in turbulent environments would use radical, fast and disruptive strategies. Strategy making should be a democratic, bottom-up process and should be organic, self-organising, adaptive and emergent. More successful companies in stable environments would use more traditional management and strategies and more formal strategy planning activities.
Palmberg (2009)	1 company in the education sector	Case study - interviews	The identified management principles in the case study are: a clearly formulated mission, delegation of responsibility and authority, diversity and competition, and follow-up and feedback. A tentative conceptual model for managing organizations as CAS - system management - is presented including; metaphor, components and approaches.
Chadwick (2010)	96 staff members employed in surgical services.	Observations	Establishing baseline data related to the perception of collaboration between physicians and nurses in the surgical arena is an important first step for nurse leaders to determine the best course of action in the change management process. Nurse leaders face the challenge of bridging the generation gap between older nurses and physicians and the younger generation, which expects everyone to be treated as equals.
Barasa et al (2016)	2 public hospitals in coastal Kenya.	Case study - in-depth interviews, documentary analysis, observations	PSRA practices in the case hospitals were influenced by,1) inadequate financing level and poorly designed financing arrangements, 2) limited hospital autonomy and decision space, and 3) inadequate management and leadership capacity in the hospital. The case study hospitals exhibited properties of complex adaptive systems (CASs) that exist in a dynamic state with multiple interacting agents.
Caffrey et al (2016)	NHS Trust - 40 staff members	Case study - email collection	Conventional ways of thinking about organisations suggest that change happens when leaders and managers change the strategic vision, structure or procedures in an organisation and then persuade others to rationally implement the strategy. Health research systems are complex adaptive systems characterised by high levels of unpredictability due to self-organisation and systemic interactions, which give rise to ‘emergent’ properties.
Burrows et al (2020)	46 healthcare providers and administrators across 13 hospitals and 6 family medicine clinics in Ontario, Canada.	Multiple-case study	Findings represent the experiences of PAs (Physician assistants) and other healthcare providers, and demonstrate how the PAs willingness to work and ability to build relationships allows for the establishment of interprofessional, collaborative, and person-centred care. A PAs role exploration revealed patterns of team behaviour, non-linear interconnections, open relationships, dynamic systems, and the legacy of role implementation as defined by complexity theory.

There are also studies that adopted complexity theory to acknowledge and explain the complex nature of several disciplines without the use of case studies and collection of primary data. These studies examine the complexity of health care (Plsek and Greenhalgh), they provide ways to approach educational leadership research through the use of strange attractor metaphors (Gilstrap, 2005), develop an understanding of what is required for sustaining organisational life by understanding complex systems (Black and Edwards, 2000). Other scholars such as Anderson et al (2005) have suggested new ways to study health care organisations by bringing together the case study method and complexity science, whereas, Goldstein, Hazy and Silberband (2008) looks at how ideas, constructs, methods and insights from complex systems can be applied to the study of social entrepreneurship.

3.2 The Evolution of Complexity Systems Thinking

A complex system consists of many parts or agents that must act individually according to their own circumstances. Agents are autonomous, interdependent, diverse, and capable of rule-oriented behaviour and they represent individuals, organisations, governments, and even societies (Caffrey et al., 2016). Agents can vary in different respects: i) they may differ in power and status, ii) they can perceive their environment according to specific belief systems, iii) they may apply a range of action principles and decision-making criteria and iv) may be more or less constrained by differential access to information (Schneider, 2012).

In order to understand the nature of complex systems, Cilliers (1998) argues that complex systems display the following characteristics: i) they consist of a large number of elements that interact in a non-linear fashion – small causes can have large results and vice versa –, ii) they are open systems that interact with the environment, iii) they operate under far from equilibrium conditions, iv) they have a history; they not only evolve through time, but their past has an influence on their present behaviour, v) their elements can interact with many others; they can influence and be influenced, vi) their interactions usually have a fairly short range, but, given the richness of the interactions, influence can be wide-ranging, vii) some interactions will involve positive and negative feedback loops, viii) the system's behaviour is the result of interactions between the elements, ix) their structure is maintained, even though the elements may be replaced and x) each element in the system is ignorant of the behaviour of the whole system; it can only act locally (Cilliers, 1998, p. 6).

Unlike traditional management theories that provide only a partial explanation of the reality of organisations, complexity theory examines the unpredictable, disorderly and unstable aspects of organisations and complements the traditional understanding of organisations by providing a more complete picture (Zimmerman et al., 1998). The most widely known approaches to complexity, depending on the focus of an investigation, are the following: simple complex systems, complex adaptive systems, complex cognitive systems, complex social systems and complex responsive processes (Kernick, 2004), complex evolving systems and complex co-evolving systems (Mitleton-Kelly, 2003) (see Table 3.2).

Table 3.2 The Evolution of Complexity Systems Thinking

Systems	Approach	Example
Simple complex systems	Manner in which information is processed by individual elements does not change with time.	Biochemical reaction
Complex adaptive systems	Processing of information by elements changes with time as they learn and adapt in response to other elements or their environment.	Evolutionary computer programs, biological systems, stock market
Complex cognitive systems	This approaches complexity from a psychological perspective and offers a useful organisational definition of a complex system.	Brain, neural systems
Complex social systems	Organisations are studied as complex social systems in their own right, not as metaphors or analogies of physical, chemical or biological systems.	Families, nations
Complex responsive processes	Interaction between individuals at the local level from which an unpredictable future emerges.	Human organisation
Complex evolving systems	Complex evolving systems co-evolve within a social ecosystem. Emergence would be facilitated and not actively inhibited; self-organisation would be encouraged and so would exploration-of-the-space of possibilities.	Organisations
Complex co-evolving systems	CCES not only adapt to changes in their environment or ecosystem, but also influence and affect that ecosystem. They have a set of characteristics that influence each other and enable them to create new order.	Organisations

Source: Kernick D. (2004) *Complexity and the Healthcare Organisation*, Oxon: Radcliffe Medical Press Ltd; Mitleton-Kelly E. (2003) *Complex Systems and Evolutionary Perspectives on Organisations: The Application of Complexity Theory to Organisations*, Bingley: Emerald Group Publishing Limited; Mitleton-Kelly E. (2006) A Complexity Approach to Co-Creating an Innovative Environment. World Futures; The Journal of New Paradigm Research, 62(3), pp. 223-239.

While all the above approaches display specific characteristics and can be applied to certain complex systems, this study focuses on complex co-evolving systems (CCES) developed by Mitleton-Kelly as a more accurate descriptor.

3.3 The Board as a Complex Co-Evolving System (CCES)

There are theorists that make the distinction between 'complex adaptive systems' that constantly adapt to the changes around them but do not learn from the process, and 'complex evolving systems', which learn and evolve from every change and thus influence their environment (The Health Foundation, 2010). Peter Allen introduced Complex Evolving Systems, a term that was subsequently developed by Mitleton-Kelly to CCES, a world more exciting than the one related to mechanical motion (Allen, 2009).

Complex systems consist of social units or agents that are processing information obtained through their interaction with each other and with the environment and, based on this information, modify their behaviour (Cilliers, 1998). The Board is a complex system that comprises directors that they interact with each other and with shareholder activists and stakeholders and as a result they may change their behaviour. As the Board modifies its behaviour in response to internal and/or external multidimensional (political, economic, sociocultural, environmental, legal) stimuli it also influences its corporate governance ecosystem (other companies, their shareholders, regulators, analysts, media, etc.) giving life to a continuous reciprocal influence and change that can be described as 'co-evolution' (Mitleton-Kelly, 2003). The force that encourages or demands the agents in a complex social system to change their behaviour is called 'selective pressure' (Pascale, Millemann and Gioja, 2000, p.27). It is a force that often challenges the agents' 'status' within the system and requires small or large changes in the actions and behaviours of individual agents. Depending on the conditions under which the system is operating at that point the change may be amplified throughout the system or dampened. These adaptive tensions give rise to non-linear instabilities within the system which often lead to novelty and innovation and make the behaviour of the system unpredictable (Pascale, Millemann and Gioja, 2000).

This unpredictability in the behaviour of complex systems was first explained by Ilya Prigogine (1997) in his study of thermodynamic systems. Prigogine distinguished within thermodynamics, the state between ‘equilibrium’ and ‘far from equilibrium’. In equilibrium dynamics, the state of a thermodynamic system that stabilises in or around an equilibrium displays a linear cause-and-effect behaviour which is largely predictable and can be explained by deterministic equations. However, when the system is pushed away from equilibrium, its behaviour starts becoming increasingly non-linear, unstable and unpredictable, able to be explained only statistically, in terms of probability.

For the purpose of this study, the Boards will be explored and studied as CCESs and will not be studied as a metaphor of another system (biological, chemical or physical). Boards as CCESs not only adapt to changes in their environment, but also influence and affect the environment and the social ecosystem they operate, a process that is reciprocal or co-evolutionary. CCESs also have a set of interrelated characteristics that influence each other and enable them to create new order (Mitleton-Kelly, 2006). In a corporate governance ecosystem, the Board influences and is influenced by all agents that are part of that ecosystem, in this case, shareholder activists, other shareholders, media, market analysts, proxy advisory firms, investment banks, stock exchanges and regulatory bodies.

Mitleton-Kelly (2003) identifies six areas in the field of complexity research under the umbrella of complex evolving systems (CES): 1) Far-from-equilibrium conditions and dissipative structures in chemistry and physics – the work of Ilya Prigogine and his co-authors, 2) Complex adaptive systems (CAS) in evolutionary biology – the work of Stuart Kauffman, 3) autopoiesis (self-generation) in biological systems – on the work of Maturana in biology and its application to social systems by Luhman, 4) chaos theory, 5) increasing returns and path dependence by Brian Arthur and other economists and 6) systems theory, cybernetics, social network theory and other work in social systems and management.

These research areas create the background to the following generic complexity principles in developing a theory of complex social systems that enable the creation of new order: connectivity, interdependence, feedback, fitness landscapes, far from equilibrium, dissipative structures, self-organisation, space of possibilities and emergence (Mitleton-Kelly, 2003). As Mitleton-Kelly (2003, p.3) further suggests: '*it is not enough to isolate one principle or characteristic such as emergence and concentrate on it in exclusion of the others*'. This study will adopt these generic complexity principles and the concepts of initial conditions and strange attractors.

3.4 Complexity Principles

One of the advantages of complexity theory is that it connects contrasting/different ideas and develops core concepts (Caffrey et al., 2016). As a metaphor, complexity and its principles provide a lens through which to observe and understand organisational activity (Smith, 2005). From the management perspective, in order to survive, an organisation must find ways to interpret events to maintain a stable environment and become more predictable. From the complexity perspective, organisations must ascertain what their environment is and find ways to interpret events in their environment, in order to enable action (Letiche, Lissack and Schultz, 2011). The vocabulary of complexity enables this study to analyse the findings yielded by interpreting shareholder activism events.

3.4.1 Connectivity and Interdependence

The critical aspects of a system's survival are the ways in which agents connect and relate to each other. When systems become connected, they start to display non-linear behaviours and these connections lead to the formation of patterns and the dissemination of feedback. In increasingly connected systems of great importance are the relationships between the agents and the richness of their connections rather than the agents themselves (McDaniel and Driebe, 2001; Meyer and Davis, 2003). In a human system, an individual's (organisation, human system) decision or action will possibly affect all related individuals and systems. However, that affect will have an unequal impact, and will change over time with the state of each related individual and system, at the time (Mitleton-Kelly, 2006).

Increased connectivity in complex systems provides more opportunities for information exchange and options for change and development (Hendrick, 2009). The degree of their connectivity, as well as time and context may influence the actions and behaviours of individuals (Mitleton-Kelly, 2003). Variety in behaviour depends on how strong and how many the connections are. Few and strong connections produce stable behaviour and many and weak connections produce unstable behaviour (Coleman, 1999). In a corporate governance social ecosystem, connectivity appears in both formal and informal processes. Formal processes may include voting, the financial press and financial analysts and corporate governance ratings agencies (rate companies on their corporate governance). On the other hand, informal processes of connectivity include talking with shareholders or stakeholders such as employees (Goergen et al., 2010).

Interdependence arises when different components of the same system become so intricately interconnected that changes in one component usually result in unexpected consequences in other components of the same system. For example, in a corporate governance ecosystem, interdependence occurs between ownership and control systems, and the stock market, but also between financial policies such as dividend policies and mergers and acquisitions (Goergen et al., 2010). All complex systems consist of elements, but the interdependencies and interactions among these elements create the whole (Anderson et al., 2005). Pushing a complex system to one side often has effects on another because its parts are interdependent. Sometimes the effect may be unimportant and sometimes it may be great (Bar-Yam, 2002).

According to Mitleton-Kelly (2006), in complexity theory, high connectivity implies a greater degree of interdependence. If elements are interdependent, then the world’s complexity at larger scales has increased (Bar-Yam, 2002). A greater degree of dependence may not always be beneficial for an ecosystem. The attempt to improve an entity’s fitness or position may result in a disadvantaged position for other entities (Mitleton-Kelly, 2006). If a pattern of interdependency in a network is disrupted, other units can still respond because they are interdependent with the disrupted unit. A complex system may become resilient and adapt to a range of environmental changes if it provides a robust response to other systems (Zimmerman et al., 1998).

3.4.2 Initial Conditions

The evolution of a complex system is sensitive to initial conditions or to perturbations (Baianu, 2011). A small change in the initial conditions at which the system's evolutionary process begins can influence its evolutionary trajectory (Mitleton-Kelly, 2003). The Board can attempt to set-up initial conditions that are conducive for the agents in the system (e.g., set up audit committees and establish code of ethics) but none can ever predict if these processes will work when the system is brought far-from-equilibrium and what the results will be. Systems will produce different solutions of initial states that are initially very close together; e.g., a ball falling on a razor blade is an example of the importance of initial conditions to a dynamic system. This is due to the reason that a very slight change in the ball's initial conditions can result in it falling to the right or left of the blade (Kellert, 1993).

An organisation will be influenced by what has occurred in the past – it must know where it has been before to see where it might go in the future. Organisations reflect past processes through which problems have been addressed (Kernick, 2004). Although initial conditions are considered important for the system's evolution, complexity theory acknowledges their importance but also perceives that a complex system always consists of a large number of interacting components that are not affected by initial conditions (Cilliers, 1998).

In stable systems, small changes are equal to small effects, whereas in complex systems, a number of smaller changes can grow quickly and in large amounts with each iteration, until no prediction accuracy is possible (Mason, 2007). In the business world, a company would ignore small changes. However, the right kind of ‘nudge’ at the right time (initial condition) can lead a complex system to major changes (Hendrick, 2009; Nilson, 1995). This is the so-called ‘butterfly effect’ and emphasises the effect of initial conditions and small perturbations on forming the emergence of a complex system. For example, the financial crisis in 2007 started in a small sector of the global economy, ‘the U.S. real estate market’. The crisis started locally (in the U.S.) and spread globally with unpredictable intensity (Choi and Douady, 2009).

According to Kuhn (2009), the history of a phenomenon should be taken into account in deciding what should be focused upon as the initial conditions. Kuhn (2009, p.58) further suggests that it is important to take into consideration the presenting circumstances of concern as the starting point and then track back into the history of this concern, as within lie the signs to why things have emerged in the way that they have. For example, it would be unwise to plan a new corporate governance structure without considering what has happened previously. Gleick (1990, p.15) cited in Kuhn (2009, p.57) found that an estimated knowledge of a system’s initial conditions and an understanding of natural law can enable the calculation of the system’s approximate behaviour. However, complexity theory is more concerned about the huge number of interacting components and their unpredictable outcomes rather than with initial conditions (Cilliers, 1998).

3.4.3 Strange Attractors

A complex system such as the Board of Directors is drawn to attractors, which are another significant characteristic of complex systems. Attractors are areas within a particular phase space (a space in which all possible states of a system are represented) that operate as 'magnets' drawing a complex social system towards a particular direction (Medd and Haynes, 1998; Pascale, et al, 2000) and are described by Kuhn (2009) as organising forces that guide behaviour or energies that motivate. When a complex system is driven far from equilibrium, the attractor that dominates the system's behaviour near equilibrium may become unstable, because of the flow of matter and energy, which is directed at the system (Prigogine, 1987). Desire to make a profit acts as an attractor in shaping money movements in the stock exchange (Kuhn, 2009).

Strange attractors are of particular interest because their form can correspond to the way in which we describe the system (Byrne and Gallaghan, 2014). The attractors of a complex system can be strange due to the reason that they may have an overall shape and boundaries that cannot be predicted with precision in terms of how or where the shape will form (Gilstrap, 2005; Zimmerman et al., 1998). The system will not go outside limits; in other words, it will allow change while maintaining some order (Mason, 2007). Pascale et al. (2000) assert that strange attractors do not occur in a complex system in isolation, but they arise from the interaction between an agent and its environment. In this case an agent is the Board of Directors and its environment is the company's corporate governance ecosystem. When a complex system is close to an attractor, it tends to remain in that location (Byrne and Gallaghan, 2014).

Strange attractors are often related to an organisation's principles and values, a condition to which the organisation always returns, and which serves as an anchor in the midst of chaos (Muller, Jooste and Bezuidenhout, 2005). In business and organisations, examples of strange attractors include the corporate vision, mission and values, corporate or organisational culture, market entry and development activities (Mason, 2007). If an organisation's corporate vision, mission and values demonstrate order and clarity, the work force might feel confident (Muller, Jooste and Bezuidenhout, 2005). Understanding attractors is critically important for organisations as getting it wrong can often lead to failure, in the form of a loss of a positive working culture or loss of market share (Kuhn, 2009).

3.4.4 Feedback

An important element that determines the behaviour of a CCES is feedback (Goergen et al., 2010). According to Mitleton-Kelly and Papaefthimiou (2002) feedback is seen as including processes that influence change in decisions, actions and behaviours between multiple elements. These processes operate at different levels: i) an individual agent, ii) a group, iii) an organisation, iv) an industry and v) the economy. In human systems, the strength of feedback is determined by the degree of connectivity (Hendrick, 2009). In these systems, agents connect to one another by feedback loops. Agents act on information exchanged within their environment and derived from other agents to whom they are connected. Systems where all of their elements are connected to each other in feedback loops are unstable (Anderson, 1999). Richardson (2008) argues that it is not just the existence of feedback loops that leads to complex behaviour. These loops must themselves interact with each other. In a relatively simple complex system containing ten parts/components there can be hundreds of interacting feedback loops that vary in their intensity and influence (Mitleton-Kelly and Papaefthimiou, 2002).

Feedback is viewed in terms of positive and negative feedback processes, that are described as reinforcing and balancing respectively (Pascale et al., 2000). Collectively positive and negative feedback can act as a counterbalance force on a complex system. Positive feedback drives change pushing the system towards instability while negative feedback maintains stability in a system (Blakesley, 2005; Mason, 2007). The reinforcement of positive feedback at a complex system will cause the system to move further away from equilibrium at an increased rate leading to an unstable state (Hendrick, 2009). In human organisations, unstable behaviour may take the form of excessive decentralisation, powerless hierarchy and refusal to conform to any rules and procedures (Smith and Stacey, 1997).

Interventions that create far-from-equilibrium conditions occur when feedback processes (negative) no longer work. Negative feedback processes can adjust or influence an organisation’s behaviour and are able to produce the desired outcome (Mitleton-Kelly, 2003). Negative feedback controls in complex systems will generate behaviour which is regular and predictable (Beckencamp, 2006; Gilstrap, 2005; Stacey, 1995). In organisations, stable equilibrium takes the form of systems such as centralised hierarchical structures, control systems using negative feedback procedures (policies, rules and budgets) and informal negative feedback control systems based on visions and missions (Smith and Stacey, 1997). In complex systems, it is the presence of feedback that enables emergence, self-organisation, adaptation, learning and other key complexity concepts (Palmberg, 2009; Richardson, 2008).

3.4.5 Fitness Landscapes

Fitness landscapes can track a complex system's development within the environment and in relation to other complex systems. A fitness landscape is a '*mountainous terrain showing the locations of the global maximum (highest peak) and global minimum (lowest valley) [and] the height of a feature is a measure of its fitness*' (Coveney and Highfield, 1995, p. 108). In a business environment, the fitness landscape is rugged, as there are peaks and valleys. High peaks would represent great fitness for an organisation (e.g. increasing sales, profitability, and market share) and deep valleys would represent almost certain extinction (e.g. low sales, low profitability). The purpose of life is to avoid valleys and climb peaks seeking a point of maximum fitness in the environment (Kauffman, 1993). Landscapes vary in their ruggedness and there are differences in the efficiency with which an agent can attain some point of improved fitness (McDaniel and Driebe, 2001).

Kauffman (1993) uses the concept of fitness landscapes, to explore how co-evolution occurs. As the agents within the environment act and change, they in turn alter and deform the landscape, therefore altering the conditions for these agents (Hendrick, 2009). In an ecosystem, the fitness landscape suggests that animals and their environment constantly interact. For example, when animals develop better eyesight and catch their prey more easily, then the prey will attempt to find ways of defending itself (Kauffman, 1993).

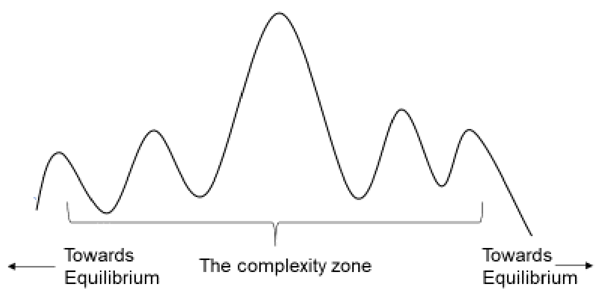
A complex system that adapts and co-evolves with the environment and continuously learns new strategies that are effective will eventually reach high peaks on the fitness landscape, indicating greater success (Zimmerman et al., 1998). In an organisational context, managers consider that their organisations should always adapt to the environment. However, every adaptive move they make creates another move by another organisation/s, and they can see that adaptation is not sufficient (Kauffman, 1993). In sectors such as health care, systems constantly attempt to improve the way they operate by seeking new peaks or fitness. They pursue new ways to accomplish better results given the circumstances they find themselves in (McDaniel and Driebe, 2001).

If a competitor within the same industry develops better technology, it has an evolutionary advantage over other companies. It is not enough for other companies to do the same; to win they have to be more innovative. This suggests that the most cutting-edge companies have strong competitive rivals forcing innovation (Lewis, 1994). On the other hand, fitness landscapes are also dangerous places for complex systems – one mistake can influence their evolution. To prevent this, a complex system looks for a secure niche within a fitness landscape that is their home (Frederick, 1998).

3.4.6 Far from Equilibrium and Dissipative Structures

Far from equilibrium is a key concept in complexity theory. Prigogine developed the concept of ‘far from equilibrium’ conditions and his work was applied to physical and chemical systems, however, because of its importance in explaining complex behaviour, his concept has been adopted in other fields e.g., corporations (Goergen et al., 2010). Prigogine distinguished the state between 'equilibrium' and 'far from equilibrium' (see Figure 3.4). The model represents a two-dimension view showing the operation of a system in the environment (Blakesley, 2005).

Figure 3.1 The Position of a System in the Environment



Source: Blakesley, P.J. (2005) *Operational Shock and Complexity Theory*. Available at: http://www.dtic.mil/docs/citations/ADA437516 [Accessed: 7 June 2016].

The left side of the model illustrates the equilibrium zone where the system is not capable of developing into a more complex state. The right side shows the zone of chaos where the system generates activity with no purpose or direction, or it is destroyed. The area in the middle of the model where each system wishes to operate is the complexity zone or 'edge of chaos'. This area protects the system from the forces of chaos or equilibrium that can pull it towards them (Blakesley, 2005). In equilibrium conditions, the system's state stabilises around equilibrium. Variations may temporarily disturb the equilibrium, and its behaviour may become unpredictable, but it then returns to equilibrium and becomes predictable again (Hodge and Coronado, 2007). The Board of Directors of a publicly listed company attempts to operate near equilibrium conditions; however, when shareholder activists acquire for the first time the company's shares, they will briefly disturb the Board's function. Following the initial perturbations, the Board will return to near equilibrium conditions.

In human systems, far from equilibrium conditions exist when a system is moved away from its established norms or away from its usual ways of working. When the system is disturbed, it may reach a bifurcation point which either leads into disorder such as loss of productivity or creates a new order and organisation e.g., finds new ways of working and relating, thus creates a new coherence (Goergen et al., 2010; Mitleton-Kelly and Papaefthimiou, 2002). Before the system's journey into disorder or creation of new order, several alternatives are possible (Mitleton-Kelly, 2006). An extensive number of tipping points can result in more complex and potentially catastrophic changes for an organisation such as decline and disorder (Frederick, 1998). In an organisational context, bifurcation may occur when a company is divided into two separate divisions, therefore creating two new companies that can each issue shares to shareholders. Shareholders in the initial company are given shares in the new company through a corporate reorganisation (Investopedia, 2017).

By continuously disturbing the equilibrium of a living system, the system's state moves to a far from equilibrium state known as 'the edge of chaos'. Operating near the edge of chaos without moving outside this zone increases the chances of survival (Meyer and Davis, 2003). The system's interaction with the outside world and its existence in non-equilibrium conditions may become the starting point for the formation of dissipative structures (Hodge and Coronado, 2007). A dissipative structure is "*an organised state that arises when a system is maintained far from equilibrium because energy is constantly injected into it*" (Anderson, 1999, p.222). This energy is fed in from outside to maintain the system's structure (Burnes, 2005) and when information is exchanged with the external environment (Mitleton-Kelly, 2003). Anderson (1999) argues that organisations are examples of dissipative structures that can only be maintained when their members are encouraged to import energy to them e.g. work productivity. When the system stops to exchange energy and information with its external environment, it become ineffective and it disintegrates. In order to avoid the disintegration, the system's agents attempt to self-organise to create a new order.

3.4.7 Self-Organisation

The focus on local connections and relationships between agents, instead of addressing different agents individually, provides information on system capacity for self-organisation (Edgren and Barnard, 2012; Kernick, 2004). Self-organisation within complex systems usually takes place when a system is far from equilibrium, or at the edge of chaos (Espinosa and Porter, 2011). It is a process that occurs spontaneously, and it involves the system or group organising itself to produce a new pattern or perform a task without any blueprint or external direction (Stacey, 2000 p. 264). In simple terms, '*it is the means by which a system talks to itself*' (Pascale et al., 2000, p. 93).

In non-human complex systems, self-organisation is observed in flocks of birds and fish as well as whole rainforests. In the case of birds and fish, there is no 'smart' bird or fish that gets things organised. Instead, the pattern of organisation develops from local interactions among agents, following simple rules (Caffrey et al., 2016; McDaniel and Driebe, 2001). In a human context, self-organisation means that the group members of a department in a company decide what they need to do (what), how their plan will be executed (how) and the correct timing (when), with no external direction (Hendrick, 2009).

Self-organisation is characterised by multiple non-linear feedback loops (Mennin, 2010). In education, teachers, learners and curriculum planners promote conditions for self-organisation through dialogue, problems, unresolved situations and questions that aim to disturb the status quo and encourage interaction and exchange (Mennin, 2010). On the other hand, an economic system is self-organising when it changes its internal structure in response to many factors (money supply, growth rate, political stability, natural disasters etc.) (Cilliers, 1998).

There are several necessary conditions for self-organisation to occur. One prerequisite is an organisational structure that can alter/change and is flexible in terms of being supervised (Edgren and Barnard, 2012). Other features include dynamic and interactive behaviour as well as many components within the system (Haynes, 2014). Self-organisation can happen in open systems that have the ability to import energy (Prigogine and Stengers, 1984), in other words systems that exchange information with their environment. An organisation that operates in a turbulent environment, must import energy to sustain self-organisation (Anderson, 1999).

When change is introduced from outside, the system self-organises around the disturbance that is created (Kernick, 2004). Because the systems in which self-organisation emerges are typically open to the influence of changes appearing in their territories, it is only by means of feedback mechanisms that these patterns survive. Even in the face of neighbouring turbulence feedback mechanisms display resilience, working to sustain their organisation (Smith and Stevens, 1994). Self-organising practices can allow a system to be innovative as it allows for experimentation and the exploration of alternatives. Some experiments will flourish because they are suitable to the new environment or social ecosystem and because they are able to evolve with their related systems within that social ecosystem (Mitleton-Kelly and Papaefthimiou, 2002).

3.4.8 Exploration of the Space of Possibilities

When a complex system faces a critical situation and past solutions do not work, it searches for new options, new solutions and attempts to create alternatives to solve the problem (Mitleton-Kelly, 2011). In order to survive and succeed, a system must explore its space of possibilities. Searching for a single optimum solution may be not be possible or desirable. A solution can only be optimum under certain conditions, but if they change, the solution may no longer be optimal. However, the existence of various solutions, will allow a system in a changing environment to draw on these alternatives that may have become relevant under the new conditions (Mitleton-Kelly, 2006).

The 2007-2008 financial crisis is an example of a system being pushed far from equilibrium. The attempts of different countries to respond to the crisis are an example of exploration of the space of possibilities, as they were exploring different options in their attempt to create new order. These attempts had an influence on other countries and the entire financial social ecosystem co-evolved through reciprocal influence and changed its way of operating (Goergen et al., 2010). Exploration of different alternative solutions also means that when the environment changes, the organisation can respond flexibly and innovatively to the new conditions (Mitleton-Kelly, 2006).

3.4.9 Emergence of New Order

Emergence requires complex systems to have at least the following characteristics: nonlinearity, self-organisation, far from equilibrium, attractors, instability and feedback loops (Goldstein, 1999; Medd and Haynes, 1998). It is a process where a system develops a complex structure from unstructured early stages (Cilliers, 1998) and it operates at the micro-macro interaction between complex systems (Mitleton-Kelly and Papaefthimiou, 2002). Non-linear interactions between different agents result in the emergence of patterns which inform and change the agents' behaviour and the system itself (The Health Foundation, 2010). The system's new structure also influences the individual agents, resulting in further changes to the overall system. Thus, the system continually evolves in hard-to-predict ways through a cycle of local interactions, emergence and feedback (Reeves, Levin and Ueda, 2016). In business, we see workers and management, through their local actions and interactions, shaping the overall structure, behaviour and performance of a firm (Reeves et al., 2016).

Emergence in human systems tends to create irreversible structures, relationships and organisational forms, which become part of the individuals' history and institutions and in turn, affect their evolution (Mitleton-Kelly, 2006). However, individual agents cannot control the system's emergence because they are unaware and ignorant of its overall behaviour (McDaniel and Driebe, 2001). Examples of emergent properties in complex social systems include structure, processes, functions, creativity, novelty and meaning (Hendrick, 2009). In human systems, the creation of new order is the ability to create and innovate, within a broad range, by including new ideas, artefacts and cultures to name a few (Mitleton-Kelly, 2006).

If an organisation is managed as a complex evolving system that co-evolves in a social ecosystem, self-organisation and the exploration of the space of possibilities would be encouraged and the emergence of new order would be facilitated. The management would comprehend that, as an entity, the organisation would be capable of creating new order and have the capability to recreate itself. Managers would then emphasise the creation of conditions that would enable continuous co-evolution within a changing environment and would urge the co-creation of new organisational form with those directly affected (Mitleton-Kelly, 2003, p.23).

From a complexity perspective, the application of emergence to corporate behaviour is important as it points out the role of the interaction between different components in a complex system – in this case executive agents and the corporate environment – in explaining outcomes. In a corporate governance environment, emergence of new order can take the form of new rules, regulations, governance frameworks, or a new culture (Goergen et al., 2010). Some examples of emergence and self-organisation are: i) new strategic developments, ii) marketing tactic developments, iii) self-directed teams and iv) growth of strategic alliances (Mason, 2007). Emergence may also include the creation of an enabling environment that facilitates good corporate governance within organisations as well as within industries and economies (Mitleton-Kelly, 2011).

3.4.10 Enabling Environment

The evolutionary trajectory of a complex system will be influenced by a number of factors that will enable it to take or inhibit it from taking a desirable course (Mitleton-Kelly, 2003). A specific direction may be desirable, but in order to achieve it the organisation may have to elaborate new behaviours. These behaviours and structures need to emerge from within the system and to be suitable to the new conditions. Consequently, the right enablers must be in place, whereas inhibitors of the desired changes and learning must be identified and reduced or even removed (Goergen et al, 2010; Mitleton-Kelly and Papaefthimiou, 2002).

Some of the enablers that Mitleton-Kelly (2003) identified in a case study involving the European operations of an international bank which had to upgrade its information systems included: new procedures, autonomy, stability and the support of a senior manager without interfering in the process. On the other hand, inhibitors included management discontinuity, differing perceptions, loss of system expertise and lack of adequate documentation. The set of enablers and inhibitors are referred to as the 'enabling conditions' that collectively make up an 'enabling infrastructure' (Goergen et al, 2010; Mitleton-Kelly and Papaefthimiou, 2002).

Goergen et al. (2010) state that there is no need to use complexity theory as an exploratory and descriptive framework. Instead, it can be used for understanding the problem space to creating an Enabling Environment that addresses the problem in a sustainable way. The corporate governance of a publicly listed company demonstrates characteristics of a complex system that respond to different triggers that form the environment of the corporation – internal and external. The enabling environment consists of the set of cultural, social, legal, political, economic and other conditions that create that environment and enable the daily running of an organisation or the creation of a new organisational form. These conditions interact and influence each other and enable the co-evolution of the internal environment with the external, broader social ecosystem (companies, regulators, shareholders and stakeholders) (Mitleton-Kelly, 2003 cited in Goergen et al., 2010).

3.5 Summary

The review of the literature in this chapter has identified and discussed one of the main subject areas in this study, complexity theory. Although agency theory is associated extensively with corporate governance and shareholder activism, its reductionist approach and partial view of the world, ignores the complexity of organisations. Complexity theory will bridge the gap in the existing corporate governance and shareholder activism literature in the hotel industry that this research aims to fill. Therefore, the Board of Directors is viewed as a complex co-evolving system that has its own agenda and supports a specific function in the corporate governance system of each company.

Complexity theory studies social systems holistically and they look at all related elements or all corporate governance agents that interact and influence each other, within the entire corporate governance environment of the social ecosystem. It will enable this research to study all related systems comprehensively by looking at the interaction and influence of all related entities in a company’s corporate governance ecosystem. The use of complexity theory as a metaphor may offer interesting insights into the way that companies operate.

The following chapter outlines the methodology employed for this study.

CHAPTER FOUR - RESEARCH METHODOLOGY

4.0 Introduction

This chapter outlines the research design of this study. It begins by evaluating the research philosophy adopted and provides a rationale for the choice of the research strategy, which is a multi-case study, and the sample selected. It then addresses the data collection techniques employed which are online documentation and archival records and presents the data collection process, including the time frame of the research and the number of sources used for data collection. Following this discussion, the chapter presents the rationale for the choice of the template analysis. Ethical standards have also been considered in order to produce a study that complies with UWL's ethical research guidelines. Finally, this chapter concludes with a discussion on the criteria utilised to assess and judge qualitative research and the limitations that have influenced the interpretations of the research findings.

4.1 The Philosophical Approach of this Study

The choice of research approach has been debated in the social sciences (Bowling, 2009). Researchers adopt a research philosophy for a study depending on the way they view the world. Their viewpoint supports the research strategy and the methods chosen as part of that strategy (Saunders, Lewis and Thornhill, 2012). There are several research paradigms for someone who embarks a research project: positivism, interpretivism, phenomenology, action or participatory research (Kumar, 2005).

The aim of this study was to provide novel insights and interpretations of the impact of 'offensive' shareholder activism on a company's corporate governance ecosystem utilising a complexity theory lens. It employed the phenomenological approach as, unlike other philosophies such as positivism, Seale et al (2004) argue that phenomenology looks at the interaction, between individuals or within groups and emphasises subjectivity rather than objectivity, description rather than analysis and interpretation instead of measurement. In order to explore the impact of shareholder activism, this study looked at cases of shareholder activism and how various interacting agents such as Board members and shareholder activists influenced each other. The researcher chose to interpret shareholder activism events based on personal perceptions and particular viewpoints that were related to the data collection techniques.

Collecting data in phenomenology can be achieved by using either mixed methods or focusing just on qualitative techniques. The phenomenological research philosophy is associated with the inductive research processes that focus on exploratory and qualitative techniques (Sekaran and Bougie, 2016). The process of induction begins with facts (collecting data) to explore the impact of a phenomenon (Birks, 2014; Brown and Hale, 2014; Miller, Strang and Miller, 2010) and generate or build theory often in the form of a conceptual framework (Saunders et al, 2012). During the research process, the study began with the data collection that enabled the exploration of the shareholder activism phenomenon. Then, the researcher arranged all data in a chronological order to simplify the analysis process and provide more clarity. Following the analysis of the data, a research study can establish meanings, identify patterns and consistencies relevant to the phenomenon under investigation, and produce new discoveries and conclusions (Gray, 2009; Lichtman, 2014).

A small sample of shareholder activism cases was chosen as opposed to a large sample that would yield extensive data and would challenge the analysis of the findings. The selection of a small sample is likely to question the value of the data and to what extent it is justifiable to generalise from the findings (Denscombe, 2010). However, Saunders et al (2012) argue that when adopting an inductive approach, a small sample may be more appropriate than a large sample and specific observations can be generalised. The above determined the choice of the research strategy adopted which is the case study approach.

4.2 Research Strategy

The aim of the study was to provide novel insights and interpretations of the impact of shareholder activism on a company's corporate governance ecosystem utilising complexity theory. In order to achieve the above, the case study approach was chosen as the main research strategy. Case study methods are often characterised as exploratory and are regarded as exploring a case or multiple cases over a certain period that involve detailed and in-depth data collection that include multiple sources of rich information in context (Brown and Hale, 2014; Shaughnessy, Zechmeister and Zechmeister, 2015; Stake, 1995). The study explored the phenomenon of shareholder activism through past events and this was accomplished by the application of qualitative collection techniques. These techniques yield rich data and allow for particularisation, getting to know the uniqueness of the case and its context (Adams, Khan and Raeside, 2014).

Case studies are particularly effective when researchers study a complex phenomenon and are useful for answering 'how' and 'why' questions (Barone, 2000;

Stewart, 2014). Questions such as ‘how’ shareholder activists target corporate boards, ‘how’ the Boards resist shareholder activism and ‘why’ both corporate boards and shareholder activists make certain choices were critical in understanding in depth of the impact of shareholder activism. Two advantages of case studies that were applied in this study were i) their ability to illustrate complex, multi-faceted events and identify processes over time and ii) explain in greater detail an entire situation or process and allow the incorporation of numerous perspectives (Neuman, 2014). The study recorded past events and followed a chronological order. The sequence of these events allowed an in-depth exploration of the cases with a comprehensive view and examined the behaviour of all interacting agents in the company’s corporate governance ecosystem.

Despite the advantages that the case study approach offers to a research study, Yin (2018) is concerned about the inability of a researcher to generalise from a single case study. In short, case studies are generalisable to theoretical propositions and not to populations. A single case study would limit the focus of the investigation even with an in-depth research design and would not allow shareholder activism to be viewed from different perspectives (Yin, 2018). Therefore, in order to avoid the limitations of a single case study, a multi-case study approach was preferred because it allowed for generalisation from the findings.

Multi-Case Study Approach

This study investigated corporate governance structures such as the Boards of publicly listed companies. Therefore, it attempts to understand patterns across organisational boundaries (Stewart, 2014). The findings yielded during the research process, allowed this study to retain comprehensive and important characteristics of real-life events such as organisational and managerial processes (Kumar, 2014; Polonsky and Waller, 2011). These events are related to the interactions between Boards and shareholder activists. Furthermore, this study evaluated real-life events such as annual general meetings where shareholders discuss and vote on a company's related matters such as the election of a new governance structure.

The purpose of a case study is to replicate and to compare in a systematic way an organisation that is under study with others and to explore different views on the issues under examination (Adams et al., 2014; McBurney & White, 2010). Each case serves a specific purpose within the overall investigation thus following a 'replication' design rather than a 'sampling' design (Blumberg, Cooper and Schindler, 2014; Yin, 2018). The selected cases have the same structure and are divided into the following parts: the target company, background information of shareholder activists and the unfolding of shareholder activism events in a chronological order. The consistency of the structure of the multi-cases facilitated the collection and analysis processes in this study. Rowley (2002) and Yin (2018) suggest that evidence from multi-cases is often considered more convincing, and the overall study is regarded more robust (Herriott and Firestone, 1983).

Multi-case studies reveal exploration, description and explanation within each case and perform some comparison and contrast in all cases (Bryman and Bell, 2011). This study compares and contrasts the findings from the selected cases in the following areas: i) the business environment for each targeted company, ii) the Boards' vulnerabilities, which triggered the interest of shareholder activists, iii) the tactics employed by shareholder activists to influence the Board of each company and iv) the Boards' defence mechanisms to withstand shareholder activism.

4.2.1 Selection of Case Studies

In order to make appropriate choices for cases in this study, a preliminary literature review showed that shareholder activists have targeted several companies in the hospitality industry with the main intention of initially influencing their Boards. An initial investigation identified 24 cases of shareholder activism in the hospitality industry in the US and Canada (see Table 4.1). Although shareholder activism has increasingly expanded in Europe over the last ten years, with the exemption of IHG there are no other recorded cases in both the hotel and restaurant sectors in the region.

Table 4.1 Shareholder Activism in the Hospitality Industry

Hotel sector companies	Country
Extended Stay America	US
IHG	**UK**
Morgans Hotel Group	**US**
Strategic Hotels & Resorts	**US**
Great Wolf Resorts, Inc	US
Chatham Lodging	US
InnVest Real Estate Investment Trust	Canada
Starwood Hotels	US
Restaurant sector companies	
Darden Restaurants Inc.	US
BJ's Restaurants Inc.	US
Cracker Barrel Old Country Store Inc.	US
Bob Evans Farms Inc.	US
Famous Dave's of America	US
J. Alexander's Corporation	US
Benihana Inc.	US
Ruby Tuesday Inc.	US
McCormick & Schmick's Seafood Restaurants Inc.	US
Red Robin Gourmet Burgers Inc.	US
Denny's Corporation	US
Kona Grill Inc.	US
Buffalo Wild Wings Inc	US
Bravo Brio Restaurant Group Inc	US
Chipotle	US
Fiesta Restaurant Group	US

Sources: Alliance Advisors (n.d.) Shareholder Activism Industry Report: Restaurants. Available from: https://allianceadvisors.com/whitepapers/shareholder-activism-industry-report-restaurants/ Accessed: [10 November 2018]. Foley, S. (2015) Hedge Funds Add to Pressure on Starwood Hotels & Resorts. Available at: https://www.ft.com/content/85ce566a-4433-11e5-af2f-4d6e0e5eda22 [Accessed: 10 November 2018]. Maze, J. (2017) Why Activists are Targeting Restaurants. Available from: https://www.nrn.com/stock-data/why-activists-are-targeting-restaurants Accessed: [10 November 2018].

The study employed a purposive or judgemental approach. The logic of purposive sampling lies in selecting information-rich cases for an in-depth study (Patton, 2015; Saunders et al., 2012). The initial emphasis was to decide on which sector the study would focus. Although it is useful to compare and contrast findings from both the hotel and restaurant sectors, it was decided to focus on the hotel sector. Therefore, despite 16 cases of shareholder activism in the restaurant sector, there was lack of 'rich' information that could yield in-depth findings. On the other hand, a preliminary analysis of eight cases in the hotel sector revealed that there was ‘rich’ information which would therefore yield in-depth insights and allow an in-depth understanding of the shareholder activism phenomenon.

Critical case sampling was used to select a small number of cases to ‘*yield the most important information and have the greatest impact on the development of knowledge*’ (Patton, 2015, p. 276). Three international publicly listed companies from the hotel sector comprised the selected sample cases. In order to achieve this, the study established a number of criteria that were critical for the selection of the cases. The first criterion was to select companies that had an international presence so the sample would be representative of the international hotel industry. The study would then be able to collect sufficient information about the selected cases. Typically, unlike national companies, international hotel companies have brands that are more reputable and inevitably attract more publicity from the media. This criterion allowed the study to shortlist four hotel companies – InterContinental Hotel Group, Morgans Hotel Group, Strategic Hotels and Resorts and Starwood Hotels and Resorts – that had an international presence during the research process.

The second criterion that enabled the study to further shortlist the cases was associated with the availability of information. In all cases, sufficient information was available; however, in the case of Starwood Hotel and Resorts there was not as much information available compared to the other three companies. Consequently, Starwood Hotel and Resorts was eliminated from the shortlisting process and the final sample consisted of Strategic Hotels and Resorts, InterContinental Hotel Group and Morgans Hotel Group.

In further analysing the three cases, an additional criterion that was not considered during the selection of the cases emerged. This was related to the different number of shareholder activists that were present in each case during the activism period. Consequently, one shareholder activist was present in Strategic Hotels and Resorts, there were two shareholder activists in the InterContinental Hotel Group and four shareholder activists in Morgans Hotel Group. Although, the final criterion was unintended, it gave the benefit of allowing investigation of how different numbers of shareholder activists could influence to a different extent the Board of a publicly listed company.

4.3 Data Collection Techniques

The most commonly used methods in case study approach are interviews and archival records (Gill and Johnson, 2010). Although, the complexity of case studies allows the use of multiple sources of data (Compton-Lilly, 2013), this study focuses on online documentary information. Due to the 'historical' nature of the study, observation would not be possible, even if access was granted. Similarly, examples of physical artefacts or objects such as flyers, agendas and training materials within the setting of the study were not relevant to the nature of the investigation.

The study took into consideration the possibility of conducting interviews alongside online documentary information. Despite the advantages the interviews can offer, it was not possible to use this technique. In March 2015, while initialising the secondary data collection process, the intention was to conduct interviews with financial analysts and senior executives from the selected cases. Initially, an effort was made to communicate with key people in the Strategic Hotels and Resorts case. However, all attempts to communicate were unsuccessful and it was decided to relinquish the interview process. This challenge can be attributed to the fact that interviews may prompt recipients not to reply because they may be worried about the information they are likely to share and may not be comfortable with interviews (Basu, 2008). The disclosure of sensitive information regarding a publicly listed company may not occur because of differing levels of trust or other factors that are outside the control of the researcher (Best, 2012). Sharing views about shareholder activism with someone that individuals did not know could put into jeopardy their companies' reputation. Taking into consideration the non-response from SHR's key people, it was decided not to contact other individuals from the other two cases.

Consequently, documentation and archival records were collected to develop the case studies. Documentation and archival records create a rich source of evidence and play a crucial role in a multi-case study research (Blumberg et al., 2014). The strengths of documentary information were evident in this study: i) they were stable (the information was reviewed repeatedly), ii) the information was not created because of the case study, iii) they were specific (contained exact names, references and details of all cases studies and events which had taken place) and iv) broad (covered a long span of time, events from the entry of shareholder activists to their exit in a company). In addition, documentary information is also an essential source of evidence and appears to be objective and truthful (Yin, 2018).

Document analysis was used to analyse the various documents collected from publications related to the case companies (See 4.3.1). It is a form of qualitative research in which all documents are examined and interpreted by the researcher to give meaning to the topic under investigation (Frey, 2018). Document analysis can also point to questions that need to be asked and it enables a research to be critical and comprehensive (Bowen, 2009a). The initial analysis of the documents resulted in the need to identify further certain aspects of the impact of shareholder activism in the selected case companies.

4.3.1 Data Collection Process

Most documents accessed were written with a specific purpose in mind, which was to portray events of shareholder activism, and were addressed to a specific audience such as financial analysts, investors, senior executives, shareholders and researchers. However, documentary information has two potential flaws. It does not provide sufficient detail to answer research questions and can result in biased selectivity, if the collection is incomplete (Bowen, 2009a; Yin, 2018). To overcome the above flaws, a thorough research process was conducted by collecting all available documents from different sources.

The documentary information was collected from various online sources. The Internet and the digitalisation of governmental, organisational and media documents (Saunders et al., 2012) enabled this study to collect data only from US and UK online sources. Despite the risks associated with its usage, the internet is a good source of information as the only problem relates to the verification of the accuracy of the collected information since often it is unedited (Corbin and Strauss, 2015). The online data collected included articles, minutes of Board meetings, reports of shareholder activism events, media reviews of each case, press releases and annual reports from the targeted companies. Online sources that were accessed, included established websites from newspapers, magazines, financial media, legal news, a company disseminating press releases for publicly listed companies, news in the hotel industry, the global travel industry, the hotel investment community and from hotel companies.

The archival records collected were in the form of qualitative information that contained some quantitative information and were available from a US independent federal government agency, the SEC. The SEC's responsibility is to protect investors and maintain fair, orderly and efficient markets. The agency also promotes full public disclosure, protects investors against fraudulent and manipulative market practices and monitors corporate takeovers. Through the EDGAR database (a SEC tool), the study accessed free corporate information for all companies and reviewed the filings that each company and shareholder activists made in regular periods. In addition, the EDGAR database allowed the study to gather information in relation to each company's financial and operating performance, Board meetings and quarterly as well as annual reports (SEC, n.d.). Finally, the EDGAR database enabled the study to overcome another flaw of documentary analysis, which is the low retrievability of data (Bowen, 2009b).

The collection of the documentary information occurred over a three-year period. However, 80% of all documents were collected during the first six months of the data collection process. As a strategy, both data collection techniques allowed the study to generate a rich description of past events, the corporate governance context within which these events occurred, the roles of all agents involved, and the influence of other external agents that were related to each company's corporate governance ecosystem. The study also analysed decision-making processes and evaluated tactics from shareholder activists and Boards (Saunders et al., 2012).

‘Rich’ information from many sources was collected over the six-month period and then the writing up of each case began to take form. During the data collection process and the data analysis process, the documents accessed were reviewed repeatedly to establish the exact causes of the impact of shareholder activism in corporate boards and examine further influences that triggered shareholder activism. After the main collection process and up to a year before (July 2019) the completion of this study, certain sources were revisited to identify new information. This process did not yield new findings but enabled the study to find existing information from different sources that corroborated the initial findings. Table 4.2 presents the documentary information collected for the three cases.

Table 4.2 Data Collected for Each Case

Case	Type of Data	Documentary Information	Number of Articles Collected	Period Investigated
Strategic Hotels and Resorts	**Online Documents**	The Guardian, Bloomberg, The Independent, Wall Street Journal, BBC, Telegraph, CNN, Business Wire, Hotel Management, Reuters, Hotel News Resource, Strategic Hotels & Resorts, Chicago Business, The New York Times, Nasdaq.	48	2012-2015
	Archival Records	SEC	26 (filings)	2013-2015
InterContinental Hotels Group	**Online Documents**	Telegraph, The Independent, Value Walk, The New York Times, Insider Monkey, Financial Times, City A.M., The Guardian, Law360, CNBC, Skift, Hotel Analyst, Reuters, Bloomberg, Hotel Owner, InterContinental Hotels Group, Market Realist, Seeking Alpha, Hotel Management, Sky News.	52	2012-2015
	Archival Records	SEC	33 (filings)	2012-2015
Morgans Hotel Group	**Online Documents**	Reuters, Law360, Morgans Hotel Group, Hotel News Now, Bloomberg, The Real Deal, Seeking Alpha, Travel Weekly, Business Wire, Hotel News Resource, New York Post, Skift, The Street, Hotel Management, Dow Jones, Financial Times, Business Insider.	75	2011-2016
	Archival Records	SEC	185 (filings)	2006-2016
Total number of sources			**419**	

The documentary information for each case was collected from online sources that often cover shareholder activism in their news headlines. Overall, 175 online documents were reviewed and were used to evaluate the impact of shareholder activism on each case. The documents were collected from established online newspapers such as The Guardian, The Telegraph, The Independent, The New York Times, The Financial Times and The Wall Street Journal, from online news providers such as BBC, Bloomberg, CNBC, CNN and Reuters and from the websites of the targeted hotel companies.

Moreover, the study reviewed 244 archival records from the SEC. These records enabled the researcher to access ‘raw’ information that was in the form of filings made by the selected hotel companies such as annual general meetings, quarterly and annual reports. In addition, the study accessed filings made by shareholder activists that were associated with the reporting of their investments. The study investigated online documents for each case from the time that a shareholder activist entered each company until their exit as recorded in these sources. The documents collected in this study provided a historical insight in all cases, as the events unfolded chronologically. This insight enabled the study to understand the origins of shareholder activism in each case.

4.4 Ethical Considerations

Ethics refer to ‘*the moral values or principles that form the basis of a code of conduct*’ (Collis and Hussey, 2014, p. 30). Qualitative researchers face ethical issues throughout each stage of the research cycle (Hennink, Hutter and Bailey, 2020) that can become a challenge when planning and conducting the research process (Flick, 2014). Researchers have attempted to overcome ethical dilemmas that occur from different social norms and contrasting philosophical approaches and have led to the development of codes of ethics. These include principles that outline the nature of ethical research and ethical standards to accompany these principles that are intended to guide researchers conduct (Saunders et al, 2012). A good case study will strive for the highest ethical standards – avoiding poor practice such as plagiarising, falsifying information, deception and encouraging honesty and acceptance of responsibility for one's work – (Yin, 2018) and promote ethical practice (Saunders et al, 2012).

This study did not involve human participants, but it was subject to minimal ethical concerns that were taken into consideration during the collection and analysis of the data, therefore contributing to the body of knowledge. During the planning process, the researcher submitted a research ethics proposal that was approved by UWL's research ethics committee. During the collection process, documentary information was collected from the Internet as it provided easy access to the data required. Despite facilitating access, Saunders et al (2012) believe that the Internet raises several issues and dilemmas about the applicability of ethical principles. A general ethical principle is related to the maintenance of objectivity, ensuring that the data are collected accurately and fully (Saunders et al, 2012). The data was collected from websites that are reliable (see Table 4.2) and are trusted by business professionals. In addition, the information was presented in an honest and transparent way, exercising objectivity.

Other ethical concerns were associated with the use of document analysis. An initial concern of this data collection method is that documents will not provide all necessary information – some will provide a small amount of valuable data and others may be incomplete or their data may be inaccurate – required to answer the research questions and require some investigation (Bowen, 2009a). In some cases, articles from online sources provided a small amount of data, however, the investigation on SEC's archival records yielded rich data and allowed to cross-check the relevance and quality of all collected information. O'Leary (2014) also argues that another concern is associated with the potential presence of biases, both in a document and from the researcher. There are documents related to the performance of a company, that may be written to influence a specific audience and exert pressure in the company. O'Leary (2014) suggests investigating the subjectivity of documents to gain an understanding of the collected data in order to maintain the credibility of the research process. Documents from various sources with similar content were investigated thoroughly to ensure that there was not any conflicting information that was likely to influence the reliability and validity of the research process. Overall, the approach taken during the data collection and data analysis processes was unbiased and followed accepted ethical principles.

4.5 Analysis of Findings

Template analysis, which is a form of thematic analysis, was chosen as the most appropriate analysis tool because it enabled this study to compare and contrast with ease data across the three cases as well as within each individual case. It is a method of thematically organising and analysing qualitative data (King, 2012) that have been widely used in organisational and management research, as well as across other disciplines (Brooks et al, 2015). It emphasises the use of hierarchical coding but balances a high degree of structure in the process of analysing textual data (Brooks et al, 2015, p. 203).

There are a number of reasons that template analysis is an appealing choice for qualitative researchers. It is a flexible approach that can be modified for the needs of a research study and compared with other methods of qualitative data analysis, it can offer a flexible technique with less specific procedures, thus, enabling researchers to tailor the approach to the requirements of their own project (Brooks and King, 2014).

Central to the template analysis is the development of a coding template that is based on the basis of a subset of data, that is then applied to additional data, revised and refined (Brooks et al, 2015). The main stages in template analysis that have been adopted in this study are the following.

Familiarisation

In this stage, all documentary information was read and key ideas and recurring themes of shareholder activism that began to emerge were noted down. Thus, the study became familiar with the content of all documentary information, therefore gaining an overview of the data collected (Ritchie and Spencer, 1994). For example, the overview of the data allowed the researcher to have a clear picture of the targets (hotel companies), the shareholder activists and the state of the business environment in each case.

A Priory Themes

After familiarisation with key issues, concepts and themes are recognised and form the thematic framework to filter and classify the data collected (Ritchie and Spencer, 1994). However, in template analysis it is acceptable to start with some a priori themes that are identified in advance and are likely to be helpful and relevant to the analysis (Brooks et al, 2015). In this study, instead of identifying themes through the collected data, the researcher created a priori themes in the form of a template that was based on complexity theory in order to analyse the selected case studies. The template framework consists of four stages: 1) initial conditions, 2) from near to far from equilibrium, 3) edge of chaos and beyond and 4) emergence of new order. The stages followed a chronological order of the events that occurred during shareholder activism in each case study. At each stage, the complexity principles were used to form questions that acted as the coding index of themes. These questions were then used to label the data in the next stage (see Table 4.3).

Table 4.3 Template Framework

Complexity Stages			
Stage 1 Initial Conditions	**Stage 2 From Near to Far From Equilibrium**	**Stage 3 Edge of Chaos and Beyond**	**Stage 4 Emergence of New Order**
What were the initial conditions in the business environment?	What was each system doing near equilibrium?	What were the tipping points in the Board? What was the role of other stakeholders?	What factors influenced the emergence of new order?
What were the initial conditions that created vulnerabilities in the Board?	Who were the strange attractors?	What were the factors that guided each system at the edge of chaos?	What is the emergence of new order?
What was the role of other primary and secondary stakeholders?	Who and when used positive and negative feedback processes?	How each system self-organised?	
	Were feedback processes influential in leading the Board far from equilibrium?	What influenced the Board during the self-organisation processes?	
	What strategies the Board used in order to reach peaks in a fitness landscape? Did the Board reach valleys?	What alternatives the Board explored (space of possibilities)?	
	When the dissipative structure of the Board stopped functioning?		
	What events led the Board far from equilibrium?		

Organise the A Priory Themes

This was a challenging and time-consuming task as the researcher did not employ software such as NVIVO to store the data and manually handled the process using Excel. The template framework was copied in three different spreadsheets and acted as the main source for all the answers (textual data) on the questions addressed. Sections of data that corresponded to each theme were then placed on each stage, including the author of that source. Each stage had a number of similar answers from different articles that covered particular events from shareholder activism.

Charting

In this stage, the specific pieces of data can be arranged in charts of the predetermined themes (Srivastava and Thomson, 2009). The charts consisted of themes that illustrate the stages of the template and of sub-themes that showed the complexity principles and corresponded to each stage. This was an important task as some 'answers' from various sources were similar and therefore had similar interpretations. In this stage, it was decided not to repeat the text in the question, but rather to add the name of the author of the source.

Interpretation

The final stage of the framework method involved the analysis of the themes and sub-themes as presented in the charts. The analysis allowed this study to identify similarities and differences between the data in all cases in the impact of shareholder activism. For example, all shareholder activists identified similar weaknesses that made the targeted Boards' vulnerable. In all cases, Boards used similar processes to defend their companies from shareholder activists. The rich data allowed the study to go beyond description and explain in-depth how Boards' self-organised beyond the edge of chaos, how they moved to far from equilibrium conditions and what the outcome of shareholder activism was in each case.

4.6 Reliability and Validity

One of the main differences between quantitative and qualitative research is in the use of and importance given to the concepts of validity and reliability (Kumar, 2014). Instead of these terms, alternative criteria for assessing qualitative research are used (Lincoln and Guba, 1985). One of these criteria is the trustworthiness criterion in terms of how good a qualitative study is. Each aspect of trustworthiness has a parallel with the previous quantitative research criteria (see Table 4.4).

Table 4.4 Criteria for Judging Research

Criteria for judging quantitative research	Alternative criteria for judging qualitative research
Internal validity	Credibility
External validity	Transferability
Reliability	Dependability
Objectivity	Confirmability

Adapted from: Trochim, W.M.K. and Donnelly, J. (2007) *The Research Methods Knowledge Base*. 3rd ed. Mason, OH: Thomson Custom Publishing.

Credibility is similar to internal validity (how believable or credible the findings are. The establishment of credible findings involved ensuring that this study was carried out according to the standards of good practice and that the researcher had correctly understood the social world (Bryman and Bell, 2011). According to Lincoln and Guba (1985) a number of strategies can increase the credibility of a research study (Lincoln and Guba, 1985). Two of these strategies used, were prolonged engagement and peer debriefing that complemented each other (Flick, 2014). While there were no participants who could be defined as experts during the research process, sufficient time was spent in the field learning and understanding the shareholder activism phenomenon. Peer debriefing provided the opportunity to test and defend the research design and the yielded findings. The above areas were discussed with peers whose views and feedback proved critical for the progression of this study. The supervisors of this study were the first peer group who provided regular feedback to the researcher about the progress of the work. Another peer group that challenged the study and provided substantial feedback was the audience at UWL's Annual PhD conference where parts of this study were presented. Feedback from peers can also improve the quality of the inquiry findings (Anney, 2014). Finally, a major triangulation technique – data triangulation – was used to increase the credibility of this study. The research of multiple authors and researchers investigating the impact of shareholder activism in the selected hotel cases were cross-examined in order to strengthen the integrity of the findings.

The second criterion for evaluating the validity and reliability of the research design is transferability. Rather than trying to demonstrate that the results generalise to all other contexts, the research design provides enough details about the specific cases that the reader can judge what other contexts might be informed by the findings (Symon and Cassell, 2012; Trochim and Donnelly, 2007). Primarily it is difficult to establish transferability because of the approach adopted in qualitative research. However, to a certain extent, this can be achieved if a researcher thoroughly describes the process adopted for others to follow and replicate (Kumar, 2014). Lincoln and Guba (1985) coined this strategy as thick description as by describing a phenomenon in detail a researcher can begin to evaluate which conclusion is transferable to the settings. The study did not only focus on describing shareholder activism in detail, but it presented a research design that consisted of case studies that had a similar structure.

The third criterion is dependability, which is the stability of findings over time, in other words it is the aspect of consistency (Korstjens and Moser, 2018). Guba and Lincoln (1989, p. 242) argue that in order to '*establish the merit of research in terms of this criterion of trustworthiness, researchers should adopt an 'auditing' approach*'. Dependability can be established by using an audit trail that involves an examination of the research process to validate the data and the study shows how the data are collected, recorded and analysed (Bowen, 2009b). In order to conduct a thorough audit, this study developed a trail that provided a clear description of the research path that included the research design, data collection decisions and the steps taken to manage, analyse and report the data (Lincoln and Guba, 1985). The study facilitated the auditing process by providing a rationale for all decisions that surrounded the research design process.

The last criterion is confirmability, which parallels objectivity – i.e., has the investigator allowed his or her values to intrude to a high degree? (Bryman and Bell, 2015). Confirmability is also similar to reliability in quantitative research and it refers to the degree to which a study's results can be confirmed or corroborated by other researchers (Anney, 2014). The interpretation of the findings in this study has been shaped by the data and was not related to bias and/or interests, by the fact that all inferences, categorisation and analyses were confirmed by the researcher's supervisory team and by the provision in the form of information within the main body of the study. Several researchers also suggest that confirmability of a qualitative study is achieved through an audit trail, reflexive journal and triangulation (Bowen, 2009b; Koch, 2006 and Lincoln and Guba, 1985).

4.7 Reflection on the Limitations of the Research Design

Like other exploratory studies, this study is subject to limitations associated with the methodology and the research process. Firstly, the lack of rich data in the restaurant sector limited the scope of the analysis. None of the 16 cases of shareholder activism in the restaurant sector could form a case study with the content and the structure of the existing cases. This is because of the lack of attention given to the restaurant sector compared to the hotel sector by online or printed media sources. However, the study drew general conclusions about the impact of shareholder activism in corporate boards in the hotel sector. A future study that could combine restaurant and hotel companies would provide insights into different sectors with different core products and services.

Another limitation was the result of the data collection techniques used. The data from online secondary sources, documentary information was obtained in a relatively short period. The unsuccessful attempt to conduct interviews with hotel executives and financial analysts restricted the provision of viewing the impact of shareholder activism from a different perspective. However, interviews with hotel executives would have increased the respondents' bias, as employees of a company under investigation may not disclose relevant information regarding shareholder activism. Compared to hotel executives and financial analysts, journalists were 'outsiders' on the cases investigated, as they did not have access to each company. This led to a different interpretation of shareholder activism interventions between 'insiders' and 'outsiders' in each case. Therefore, journalists might have been biased as to what events to report and what opinions to express about shareholder activism. Conducting interviews would allow data triangulation as the findings from the interviews would be compared and contrasted to secondary sources.

An additional limitation is the scarcity of archival records. The only source from which this study was able to access archival records was the SEC. SEC's online archives were comprehensive and included detailed information that was useful for the presentation of each case study but did not cover shareholder activism as a standalone topic. The records uploaded in SEC were filings made by all companies and shareholder activists including quarterly and annual reports. With the exemption of SEC, there were not any other available public archives where shareholder activism facts and events could be obtained. Having said that, the study managed to access a great number of online sources such as newspapers, magazines and the websites of the selected companies.

4.8 Summary

This study aims to provide novel insights and interpretations of the impact of 'offensive' shareholder activism on a company's corporate governance ecosystem utilising a complexity theory lens. Phenomenology is associated with this study as it looked at the interaction of actors among the cases investigated and focused on interpreting events of shareholder activism over certain past periods. The phenomenological research philosophy was supported by qualitative data collection techniques such as documentary information. The application of a multiple-case research design and the collection of rich data enabled this study to investigate a contemporary phenomenon, the emergence of shareholder activism within its natural setting. The three companies that comprised the sample of this study were selected through the logic of purposive sampling and through the application of a number of criteria.

The analysis of the findings collected was accomplished by the framework method and its five interconnected stages. This method provided a number of advantages to this study such as data comparison on the cases investigated, description and interpretation of shareholder activism events, therefore, allowing the researcher to be systematic and structured. Rather than identifying themes from the findings, this study created a template that consisted of four stages/themes before beginning the interpretation of events in all cases. Each stage/theme was based on complexity theory and contained questions that included complexity principles. The chapter concludes with a number of different criteria suggested by Lincoln and Guba (1985) that are utilised to judge or evaluate a qualitative study. Finally, this chapter addresses ethical issues and limitations associated with this study.

The next chapter presents the three cases selected, Strategic Hotels and Resorts, the InterContinental Hotel Group and Morgans Hotel Group. The chapter presents the findings for each case and follows a chronological order that spans from the entry of shareholder activists to each target to their exit from the case companies.

PART 2 - FINDINGS

The second part of this study examines the shareholder activism phenomenon and presents the secondary data obtained from three international hotel companies. Chapters 5,6 and 7 present the impact of shareholder activism in Strategic Hotels and Resorts, Intercontinental Hotels and Resorts and Morgans Hotel Group respectively. The case studies follow the same format in presenting the data and facts to ensure consistency and provide an understanding of the research problem with greater clarity. Each case study begins with background information such as financial and corporate governance for the key players (target company and shareholder activists) and it is followed by a presentation of key events that took place during the shareholder activism period. The discussion of these key events begins with the entry of shareholder activists in their targets and it is concluded with their exit from each company.

CHAPTER FIVE - CASE STUDY I STRATEGIC HOTELS & RESORTS

5.0 Introduction

The aim of this case study is to analyse Orange Capital's (OC) investment and activism targeting Strategic Hotels and Resorts (SHR). Their relationship was challenged after OC made several interventions in SHR's Board of Directors over a 14-month period (January 2013–May 2014). During their activism, OC urged SHR's sale with the ultimate intention of generating a premium price per share ($11-$14). The allegations it levelled at the company included: i) poor corporate governance, ii) undervalued portfolio and iii) financial instability.

After a series of events throughout the activism period, OC sold their shares in SHR in May 2014. On 8 September 2015, the Blackstone Group (a Private Equity Firm) acquired SHR for approximately $6 billion. However, almost a year later on 27 September 2016, Blackstone sold the company to Anbang Insurance Group (Chinese holding company) for approximately $6.5 billion.

5.1 The Players

<u>The Target</u>

SHR was a real estate investment trust (REIT) founded in 1997 by Laurence Geller, a hotel veteran, with the name at the time of Strategic Hotel Capital, L.L.C. The company was incorporated in Maryland in 2004 to acquire and asset-manage upper upscale and luxury hotels that were subject to long-term management contracts. SHR completed its IPO on 24 June 2004 raising approximately $246.4 million by selling 17,600,000 shares at $14 per share (Crain's Chicago Business, 2004). In 2004, SHR's business strategy focused on building a portfolio of hotel properties and becoming a preeminent owner of upper upscale and luxury branded hotels primarily in the United States with selected international presence. SHR believed that its future growth would be driven by executing a two-fold business strategy, focusing on maximising asset values and operating results through systematic asset management and research-driven capital deployment through acquisitions (SEC, 2004a)[1].

Before its IPO, as of 31 December 2003, SHR had an interest in 14 properties (see Table 5.1) that were acquired between 1997 and 2001. The majority of the acquisitions occurred in the first two years since the REIT's inception. SHR's interest in each property is summarised as follows: i) 12 properties of the company's portfolio in 2003 were subject to mortgages, ii) in two properties, the company was restricted from selling these properties, iii) in one property, SHR had a ground lease interest and iv) in one property, SHR had a 35% join venture interest, and two of its properties were acquired on the dates indicated in Table 5.1, but were subsequently sold to a third party and leased back by SHR.

[1] SEC (2004a) Form S-11 - Registration Statement under the Securities Act of 1993 [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1057436/000112528204000516/b329974_s11.htm [Accessed 16 March 2017].

Table 5.1 SHR Hotel Portfolio as of 31 December 2003

Hotel	Location	Number of Rooms	Date Acquired
Hyatt Regency (1)(*)	New Orleans, LA	1,184	Sep-97
Embassy Suites(*)	Lake Buena Vista, FL	333	Sep-97
Marriott Lincolnshire Resort(2)(*)	Lincolnshire, IL	390	Sep-97
Four Seasons Mexico City(*)	Mexico City, Mexico	240	Dec-97
Hyatt Regency (*)	Phoenix, AZ	712	Jan-98
Hilton Burbank Airport and Convention Center(*)	Burbank, CA	488	Jan-98
Marriott Rancho Las Palmas Resort(*)	Rancho Mirage, CA	444	Jan-98
Paris Marriott Champs Elysées(4)	Paris, France	192	Feb-98
Loews Santa Monica Beach Hotel(1)(*)	Santa Monica, CA	342	Mar-98
Marriott Chicago Schaumburg(*)	Schaumburg, IL	398	May-98
Hyatt Regency La Jolla at Aventine(*)	La Jolla, CA	419	Jul-99
InterContinental Prague(3)(*)	Prague, Czech Republic	372	Aug-99
Marriott Hamburg(4)	Hamburg, Germany	277	Jun-00
Four Seasons Punta Mita Resort(*)	Punta Mita, Mexico	140	Feb-01
(1) We are restricted by agreement from selling these properties other than in a transaction that will qualify as a tax deferred exchange for varying periods and must maintain a specific minimum level of indebtedness encumbering the Loews Santa Monica Beach Hotel until a future date.			
(2) We have a ground lease interest in this property.			
(3) We have a 35% joint venture interest in this property.			
(4) These properties were originally acquired on the dates indicated in the table, but were subsequently sold to a third party and leased back by us in transactions that are more fully described below under “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Recent Trends and Events - Sales of Hotels”.			
(*) These properties are subject to mortgages as more fully described under “Mortgage Indebtedness Outstanding after This Offering”.			

Source: SEC (2004b) Amendment No.1 to Form S-11 [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1057436/000112528204001524/b329974_s11a.htm [Accessed 16 March 2015].

After 2003, SHR acquired a number of hotels and the company’s portfolio grew to 20 properties with a total of 10,000 rooms and a presence in six countries (Czech Republic, France, Germany, Mexico, the UK and the US) (see Table 5.2). However, after the company’s decision to focus on its native market and dispose of its international brands, its hotel portfolio was gradually reduced and prior to its acquisition by Blackstone, SHR's portfolio consisted of 17 hotels with a presence only in the US market.

Table 5.2 SHR Hotel Portfolio 2004-2015

Strategic Hotel & Resorts 2004 - 2015			
Year	**Number of Hotels**	**Number of Rooms**	**Countries Present**
2004	15	6,192	5
2005	18	8,480	5
2006	20	10,000	6
2007	20	9,044	6
2008	19	8,347	6
2009	17	8,002	6
2010	16	7,630	5
2011	17	7,762	4
2012	18	8,271	4
2013	18	8,272	4
2014	17	8,075	2
3rd Quarter 2015	17	Approximately 8,000	1

Source: SEC (2015a) Form 10-K. Annual Report [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1057436/000105743615000012/bee-20141231x10k.htm [Accessed 15 March 2017]. SEC (2015b) Form 10-Q. Quarterly Report [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1057436/000105743615000051/bee-2015930x10q.htm [Accessed 15 March 2017].

SHR's properties were found in desirable urban and resort markets in the US and Europe. The company's total portfolio as of 30 September 2015 consisted of approximately 8,000 rooms, 875,000 square feet of multi-purpose meeting and banqueting space, featured restaurants, wine and cocktail bars, high-end spas and retail offerings. Asset management was the core competency and the company's competitive advantage was driven by its team's depth of knowledge, hands-on expertise and inspired vision for every portfolio aspect. Prior to its acquisition, the company presented itself as the REIT that '*purely focuses on the upper-upscale and luxury lodging market*' (SHR, 2015).[2]

Financial Performance 2006-2015

Like any business in the hotel industry, the 2007-2008 financial crisis influenced SHR's financial performance. Geller, in an interview during the Hotels and Casinos Summit in February 2007, revealed ambitious plans for the company. SHR was planning to spend $500 million to $750 million in capital expenditures over the 2007-2010 period to expand and upgrade its hotels (Reiter, 2007). However, the housing market crash and credit crisis in October 2007 put a halt to Geller's plans for SHR's growth. Despite a steady revenue growth from 2006 to 2008 reaching approximately $841 million, the company's revenues declined in 2010 reducing to $647 million. In 2011, SHR's performance began to recover along with improvements in the overall lodging market and by the 3rd quarter of 2015, revenues increased by 42% reaching approximately $1 billion (see Table 5.3).

[2] SHR (2015) About Strategic [Online]. Available at: http://www.strategichotels.com/about.php [Accessed 17 February 2015].

Table 5.3 SHR Revenue and Net Income 2006-3rd Quarter 2015

Year	Revenue ($)	Revenue Change %	Net Income ($)	Net Income Change %
2006	626,969,000		122,719,000	
2007	873,879,000	39%	68,771,000	-44%
2008	841,291,000	-4%	-317,486,000	-562%
2009	615,398,000	-27%	-246,433,000	-22%
2010	647,365,000	5%	-230,800,000	-6%
2011	730,046,000	13%	-4,852,000	-98%
2012	775,217,000	6%	-58,261,000	1101%
2013	900,013,000	16%	9,887,000	-117%
2014	1,089,082,000	21%	341,050,000	3349%
Nine months ended in September 30, 2015	1,036,607,000	-5%	58,759,000	-83%

Source: SEC (2011) Form 10-K. Annual Report [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1057436/000119312511045475/d10k.htm. [Accessed 15 March 2015]. SEC (2014a) Form 10-K. Annual Report [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1057436/000105743614000006/bee-20131231x10k.htm [Accessed 15 March 2015]. SEC (2015d) Form 10-K. Annual Report [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1057436/000105743615000012/bee-20141231x10k.htm. [Accessed 8 January 2016]. SEC (2015e) Form 10-Q. Quarterly Report [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1057436/000105743615000051/bee-2015930x10q.htm [Accessed 8 January 2016].

SHR's biggest challenge during the period 2008-2012 was the fact that the company had to operate at a loss. For the first three years (2008-2010) the loss was high as it reached $317 million in 2008 representing almost one third of the company's revenues. In its 2008 annual report, SHR noted that the negative impact of travel during the financial crisis led to a reduction in revenues at the company's hotel properties. The company blamed the decline in occupied room nights in all segments of the business, both leisure and business demand, that was partly replaced by less expensive discount and heavily negotiated business. In addition, SHR had a substantial amount of outstanding debt, a portion of which bore interest at a variable rate. As of 31 December, 2008, SHR had a total debt of $1.7 billion, and, including the effect of interest rate swaps, 15.3% of the company's total debt had variable interest rates and 84.7% had fixed interest rates (SEC, 2009a).[3] Even though the US economy had recorded the lowest rate ever in its history (0.25% on 16 December 2008) because of the financial crisis (Business Insider, 2015), companies like SHR had financial obligations that impacted on their cash flow.

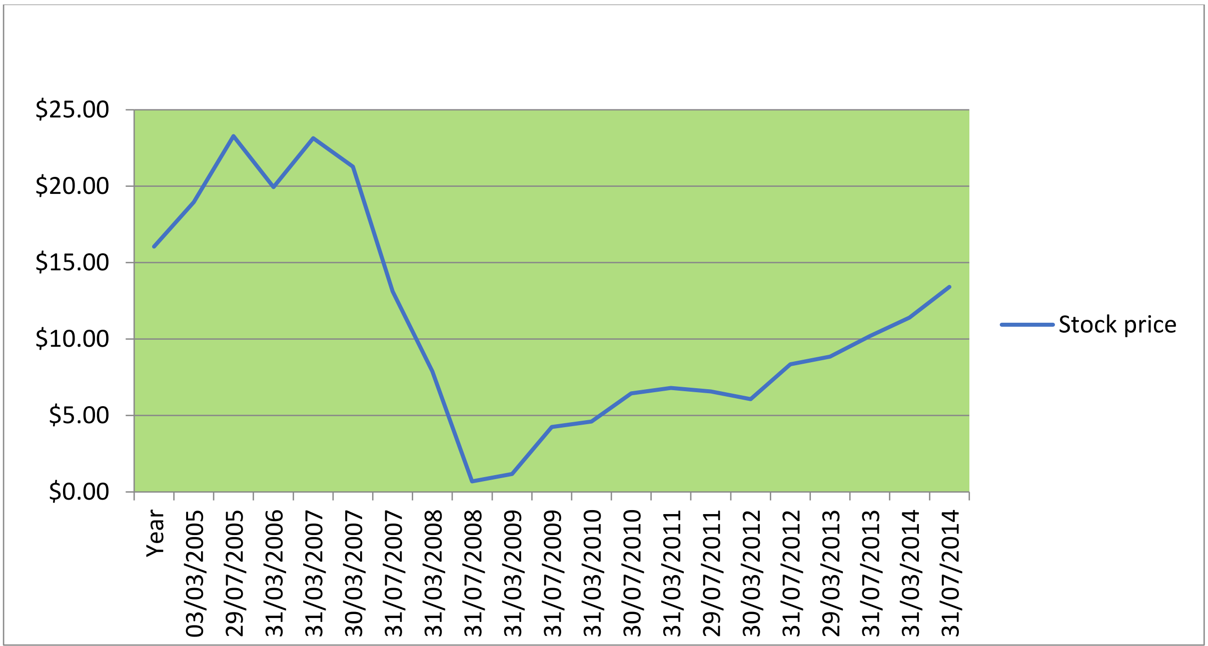
The following year, SHR recorded another loss year of $246 million because of a 22.5% decrease in room revenues and a food and beverage revenue decrease of 25.8% compared to 2008. During the last quarter of 2009, the company sold the Four Seasons Mexico City and Renaissance Paris (SEC, 2010a).[4] Wes Golladay, an analyst with RBC Capital Markets stated that SHR was one of the worst positioned hotel REITs during the downturn (NASDAQ, 2015). Heinzl (2011) added that during the financial crisis, the share prices of some REIT's including SHR had fallen more than 50% while, according to Green Street Advisors, a research firm that tracks real estate securities, REITs were trading at about a 30% discount to net asset value, on average (Marino, 2008). Over the next three-year period, SHR continued to run at a loss, for example, in 2012 the company made a loss of approximately $58.2 million. The situation became brighter from 2013 when the company started to come back into profit. From a profit of $9.8 million in 2013, SHR achieved $58.7 million in the third quarter of 2015.

[3] SEC (2009a) Form 10-K. Annual Report [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1057436/000119312509042565/d10k.htm [Accessed 15 March 2015].
[4] SEC (2010a) Form 10-K. Annual Report [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1057436/000119312510040780/d10k.htm [Accessed 15 March 2015].

Share Price

After a strong growth between 2005 to mid-2007 (in July 2007, SHR's share reached $24.35 per share), SHR's share price plummeted to its lowest level ($0.61) in March 2009. By March 2009, the company was showing signs of recovery, its share price gradually started to increase and it peaked at $13.42 per share in January 2015 (Alva, 2015) (see Figure 5.1).

Figure 5.1 SHR Share Price 2005-2014



Source: Morningstar (2015) Strategic Hotels & Resorts Inc BEE, [Online] Available at: http://quotes.morningstar.com/stock/BEE/s?t=BEE&region=USA [Accessed: 23 November 2015]

On 8 September 2015, Blackstone, the world's largest private-equity firm agreed to buy SHR for $6 billion including the company's debt (Carmiel, 2015; Minaya, 2015). On the same day, SHR's shares gained 3.5% reaching $14.07 per share (Ingram, 2015). Subsequently, on 11 December 2015, SHR confirmed the completion of the acquisition of the company by Blackstone Real Estate Partners (PR Newswire, 2015a). Prior to its acquisition by Blackstone, SHR's market capitalisation as of 17 August, 2015 was about $3.8 billion (Jaisinghani, 2015).

Gellein who was SHR's CEO in 2015 stated that the closest rivals of the company in the luxury hotel space were Pebblebrook Hotel Trust and LaSalle Hotel Properties (Alva, 2015). From 2009-2015 the share price performance of both Pebblebrook Hotel Trust and LaSalle Hotel Properties followed a similar pattern to SHR's performance. The poor performance of the share price of both companies shows the challenges and difficulties that most REITs faced during the post financial crisis period. However, after the second half of 2009, the share prices of the above REITs showed rising trends with a few fluctuations for each of them.

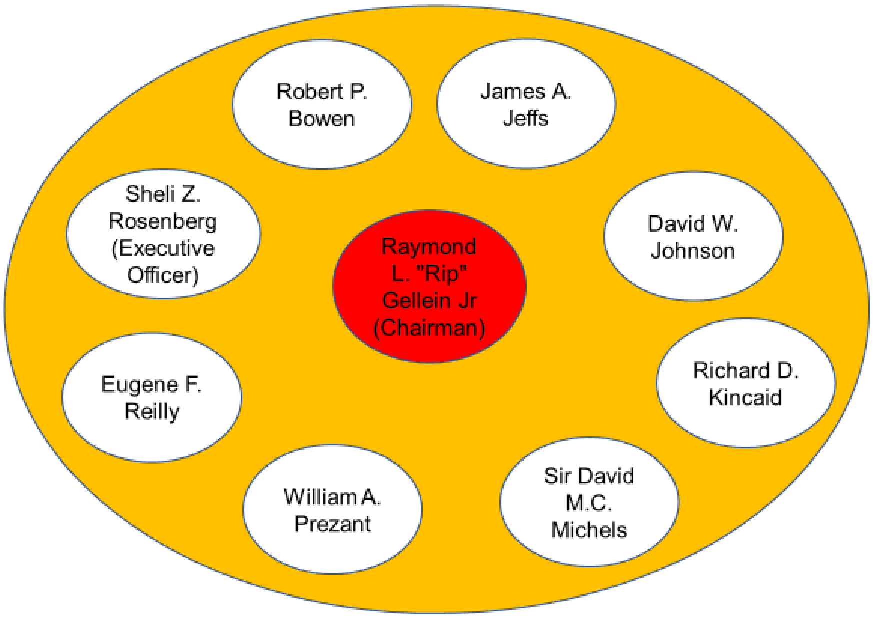
Leadership

Prior to Raymond Gellein's leadership – he was SHR's CEO during the company's acquisition – Laurence Geller was the founder and led the company from 1997. Geller's unexpected resignation with 'little explanation' in November 2012 sent the share up 13%, the highest in 31 months at the time (Edmondson, 2013; Sutherland, 2012). Commenting on Geller's resignation, Enrique Torres, an analyst with Green Street Advisors, argued that the way it was communicated indicated mutual separation; however, the way it was handled suggested that there may have been more reasons (Bergen, 2012). Talking about the new phase that SHR entered, Geller stated that '*it is an excellent time to transition leadership of the company into Rip's Gellein more-than-capable hands and focus on my myriad other activities and the next chapter in my life*' (Carr, 2012).

Raymond L. ‘Rip’ Gellein Jr. took over SHR’s CEO role after being at the company since August 2009 serving as a member of its Board and from August 2010 being the company’s chairman (Bergen, 2012). Torres noted that Gellein had a track record of selling a public hotel company earlier in his career, having sold Vistana (a resort developer) to Starwood, while on the other hand Geller was perceived as an unwilling seller (Gallun, 2012). For many people, the news about Geller’s departure was surprising and led to speculations about the sale of the company (Sutherland, 2012). At an SHR Investor Conference call that took place on 2 November 2012, the succeeding CEO, Gellein, in a question about the possibility about the company’s sale replied that ‘w*e think that we’re on the right track, we’ve got a strong team, we’ve got a great collection of hotels, and so we’re going to keep on going on*’ (Gallun, 2012). Gellein’s statement did not directly answer the questions about SHR’s potential sale. However, responding to an analyst’s comment about his willingness to consider ‘strategic alternatives’, Gellein said, ‘*the CEO has to look at all strategic alternatives*’ (Gallun, 2012).

As of 21 May 2015, SHR’s Board of Directors consisted of nine members (see Figure 5.2). Two members of the Board were also executive officers of the company. Gellein was the Board’s chairman, president as well as the CEO of the company after Geller resigned. Sheli Rosenberg was the Executive Vice President and Chief Financial Officer of SHR.

Figure 5.2 SHR Corporate Governance Structure as of 21st May 2015



Source: SEC (2015f) Form 8-K. Submission of Matters to a Vote of Security Holders [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1057436/000105743615000028/0001057436-15-000028-index.htm [Accessed 16 June 2016].

The remaining Board members were independent and had no direct interest at SHR with the exception of David Johnston who was OC's employee. An interesting membership was that of Richard D. Kincaid who was the President and Chief Executive Officer of Equity Office Properties Trust until its acquisition by the Blackstone Group in February.[5] Finally, William A. Prezant served as SHR's chairman from January 2007 to August 2010.

[5] Luxury Hospitality Daily (2017) Strategic Hotels & Resorts Appoints Richard Kincaid New Independent Director; Announces Resignation of Edward Coppola [Online]. Available at: http://www.luxury-hospitality-daily.com/news-20965-Strategic-Hotels-Resorts-Appoints-Richard-Kincaid-New-Independent-Director-Announces-Resignation-of-Edward-Coppola-.html [Accessed 8 October 2017].

5.2 The Activist

Orange Capital, LLC

Orange Capital, LLC was an employee-owned hedge fund based in New York that was formed in 2005 by Daniel Lewis and Russell Hoffman (CNW, 2014). OC primarily provided its services to pooled investment vehicles. It invested in public equity, fixed income markets, notes, index options, stock options, and other hedging markets. It also invested in value shares of companies by employing fundamental analysis to create its portfolios. The hedge fund obtained external research to complement its in-house research activities and was interested in companies in consumer products, industrials, telecommunications, healthcare, retail, media, and entertainment sectors (Bloomberg Business, 2015). As of 31 December 2015, OC's total portfolio was valued at almost $1 billion and the hedge fund held interest in companies from various industries such as hospitality, media and banking services (see Table 4.4). OC's portfolio is presented in order of the highest value for the companies they had an interest in.

Table 5.4 OC Portfolio as of 31st December 2015

Company	Industry	Shares held	% of Share Hold	Value ($)
ISHARES TRUST	Exchange Traded Fund	4,640,000	52,63	522,046,000
AMAYA INC	Gambling	5,988,899	7,6	75,443,000
NEXSTAR MEDIA GROUP INC	Media	1,197,783	7,08	70,310,000
AMERICAN CAPITAL LTD	Diversified Investments	4,777,601	6,64	65,883,000
HOWARD HUGHES CORPORATION	Real Estate	519,004	5,92	58,730,000
NORTHSTAR REALTY FINANCE CORPORATION	REIT	3,083,137	5,29	52,505,000
DEERE & CO	Manufacturing	537,500	4,13	40,995,000
PATTERN ENERGY GROUP INC	Energy	1,939,573	4,08	40,556,000
BELLATRIX EXPLORATION LTD	Oil & Gas	32,727,712	3,91	38,791,000
NORTHSTAR REALTY EUROPE CORPORATION	REIT	1,586,615	1,88	18,738,000
ABENGOA YIELD PLC	Electric Utilities	194,504	0,37	3,752,000
NORTHSTAR ASSET MANAGEMENT GROUP INC	Asset Management	207,870	0,25	2,524,000
MEDIA GENERAL INC	Media	99,195	0,16	1,602,000

Source: Insider Monkey (2017a) 13F Holdings, [Online] Available at: http://www.insidermonkey.com/hedge-fund/orange+capital/510/holdings/#/ffp=2015-12-31&fot=7&fso=0&pfp=-1&fundType=0 [Accessed 10 March 2018].

OC's investments were diverse in terms of value and ranged from approximately $522 million to approximately $1.6 million. Despite the interest OC had in a number of companies, in the beginning of February 2016, it announced that it would close its fund after 10 years. One of the key reasons behind OC's decision was the lack of liquidity in the credit market as funds could not sell their assets quickly enough to get the money to return to their investors. Despite the fund's positive performance – it produced annualised returns of 9.7%, the fund's main fund fell 7.4% in 2015 (La Roche, 2016). Subsequently, OC returned approximately $1 billion to investors.[6]

5.3. Case Overview

Prior to presenting the case, it is important to note the period within which OC bought and sold SHR shares. Table 5.5 presents OC's number of shares held during the activism period. The case is presented in chronological order to illustrate OC's intervention in the workings of SHR's Board of Directors.

Table 5.5 OC Shares in SHR

Period of Report	Number of Shares	($) Value	Shares in SHR sold
31st March 2013	7,459,964	62,291,000	
30th June 2013	7,559,964	66,981,000	
30th September 2013	7,559,964	65,620,000	
31st December 2013	8,295,651	78,394,000	
31st March 2014	2,803,614	28,569,000	After 15 May 2014

Sources: Business Wire (2013a) Orange Capital, LLC Urges Immediate Sale of Strategic Hotels & Resorts in Letter Sent to the Board of Directors [Online]. Available at: http://www.businesswire.com/news/home/20130219006297/en/Orange-Capital-LLC-Urges-Sale-Strategic-Hotels#.VPTwn_msWSo [Accessed 23 February 2015]; SEC (2013a) Form 13F [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1426756/000091957413003332/d1372516_13f-hr.txt [Accessed 23 February 2015]; SEC (2014b) Form 13F [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1426756/000091957414001344/xslForm13F_X01/infotable.xml [Accessed 23 February 2015]

In January 2013, OC, for the first time, bought SHR shares ($6.89 share price value); however, the filing for the first quarter occurred on 31 March 2013. By the end of 2013, the fund's number of shares increased by 835,687 shares indicating their strong interest in SHR. During the first quarter of 2014, OC's number of shares decreased by

[6] FINalternatives (2017) Orange Capital to Close, Return $1B to Investors [Online]. Available at: http://www.finalternatives.com/node/32477 [Accessed 15 June 2018].

approximately 30% representing a total value of $28.5 million. After the first quarter of 2014, OC sold its entire shareholding to SHR ($7.96 share price value).

5.4 Shareholder Activism Events

The section below presents in detail how the events unfolded during the activism period. The events during the activism period span just two years, 2013 and 2014. Prior to presenting the case, a summary of key events is provided (see Table 5.6) in order to enable the reader to gain an overall understanding of the case.

Table 5.6 Overview of Key Events during the Shareholder Activism Period

Dates	Event
2013	
January	OC bought for the first time SHR common stock.
19th February	OC went public urging for sale of SHR (issued a letter).
19th February	SHR rejected OC's urge for sale of the company.
End of February	OC increased its holdings to 6,625,800 million shares.
End of February	OC reiterated the sale of SHR after 2012 poor fourth quarter loss.
End of February	SHR's Board of Directors rejected OC's suggestions
20th May	SHR's Board of Directors approved an amendment to the company's stockholder rights plan to accelerate the expiration date from the 30th November 2013, but no later than the close of business on June 14, 2013.
June	Reports surfaced that SHR had put itself up for sale.
20th November	OC issued a press release announcing its intention to nominate four independent directors to the Board of Directors of SHR for election at the 2014 Shareholders Annual General Meeting.
12th December	SHR agreed to sell the Four Seasons Punta Mita Resort for $200 million.
20th December	OC sent a letter to SHR outlining that the sale process was non-marketed and exclusively negotiated basis with a major shareholder.
2014	
7th March	SHR in a press release announced that it had reached an agreement with Orange Capital, and agreed to appoint David W. Johnson to the company's Board of Directors.
7th March	OC withdrawn its notice of nomination of the remaining director candidates to the SHR Board and had agreed to vote its shares in favour of each of the company's nominees at the 2014 Annual Meeting.
7th March	OC agreed to a customary standstill provision.
May	OC reduced its stake to an approximate value of $28 million.
End of May	OC sold its stake
2015	
8th September	The Blackstone Group acquired SHR for approximately $6 billion.
2016	
27th September	Blackstone sold the company to Anbang Insurance Group for approximately $6.5 billion.

5.4.1 Period I: January 2013 - December 2013

In a filing with the SEC regarding its stock holdings as of 31 December, 2012, OC did not list any SHR shares. In January 2013, OC bought, for the first time, SHR shares ($6,89 share price value) after the company's Board acknowledged the receipt of a letter (1 February) by the fund. In a press release, towards the end of February, OC claimed to own 6.25 million shares of SHR's common stock (Heschmeyer, 2013; SEC, 2013a).[7] Prior to OC's move to SHR, in January, the US President Barack Obama welcomed a deal that had been reached to avert a 'fiscal cliff' of huge tax rises and spending cuts that subsequently led to a rally of global stock markets (BBC, 2013). US investors reacted positively and the Dow Jones Industrial Average opened up 224 points, while London's FTSE closed up 129.5 points (Fletcher, 2013). This was related to the so-called 'January effect' where, according to Clancy (2013), the stock market usually rises in January, as investors that had sold out their holdings in December, to book profits and offset losses, buy back into the market.

OC issued a letter on 1 February (see Appendix 1) to SHR's Board urging an immediate sale of the company. The fund made this letter public on 19 February due to their failure to receive an adequate response from SHR's Board. At the time of the release, OC was the beneficial owner of 6.25 million shares or 4% of SHR common stock (Bomkamp, 2013; Business Wire, 2013a; Reuters, 2013). OC highlighted the following points in its letter to SHR:

[7]SEC (2013b) Orange Capital LLC - Form 13F-HR-Quarterly Report Filed by Institutional Managers, Holdings [Online]. Available at: http://www.sec.gov/Archives/edgar/data/1426756/000091957413001376/0000919574-13-001376-index.htm [Accessed 10 March 2015].

1. Private market values for luxury hotel properties far exceeded public market valuations.

2. There was a large pool of well-capitalised buyers for the company’s luxury hotels.

3. SHR was burdened with material corporate overhead diluting shareholder returns.

4. SHR’s large portfolio of luxury hotels was unique and had outstanding scarcity value.

5. The company had a material cost of capital disadvantage compared to other owners of luxury hotels.

6. SHR’s leveraged balance sheet offered few prospects for a return of capital to shareholders for the foreseeable future.

7. SHR’s management lack of a credible plan for creating shareholder value.

OC believed that the sale of SHR’s portfolio would likely result in earnings of $11-$14 per share, a 40-79% premium over the most recent closing price at the time. OC based their valuation on a property level analysis using capitalisation rates, replacement costs and comparable M&A transactions. Qualitative variables such as the scarcity value of luxury hotel assets and favourable conditions in the capital markets were also taken into consideration (NY Business Journal, 2013a). OC reached this conclusion after carefully evaluating other possible alternatives, including SHR continuing its course as an independent company or a partial sale of the company’s portfolio with earnings used to retire debt (complete repayment of debt) (StreetInsider, 2013). OC also claimed that SHR lacked a solid plan for the future after its CEO resigned abruptly in the previous year (Bomkamp, 2013).

On the same date, SHR provided a response to OC's press release stating that the company '*strongly disagrees with certain assumptions and conclusions*' made by the shareholder activist in its letter (Hotel Analyst, 2013a). Although, SHR stated that they were disappointed that OC had released its letter publicly, supposedly to advance its short-term trading interest, they also stated that they remained open to strategic opportunities to enhance the company's portfolio and would always act to enhance long-term shareholder value (Hotel Analyst, 2013a; SHR, 2013a).

In spite of SHR's accusations, OC had actually increased its holdings to 6,625,800 million shares or 4.24% of common stock and remained one of SHR's top shareholders (Hotel News Resource, 2013a). At the end of February, SHR posted a deeper fourth-quarter loss, intensifying the pressure exerted by OC. The loss amounted to $36.4 million, compared with a loss of $15.9 million a year earlier (Eisen, 2013). SHR's loss was impacted by the need to settle $18.8 million in impairment losses, a $7.8 million charge related to the termination of the management agreement at one of its hotels, Hotel Del Coronado in San Diego, and a $2.5 million severance charge.[8] Funds from its operations were 6 cents per share which was down from 11 cents per share a year before, while revenue rose to $224.1 million from $193.9 million (NY Business Journal, 2013b).

Following SHR's poor fourth-quarter loss, OC reiterated that a sale of SHR would net $11 to $14 per share. SHR's shares were trading at $7.36 a share on February. The fund stated that one key consideration for urging the sale was SHR's poor corporate

[8] Severance pay is the compensation an employer provides to an employee who has been laid off, whose job has been eliminated, who has decided to leave the company through mutual agreement, or who has parted ways with the company for other reasons.

governance. The fund believed that the company made several arrangements that had established and enriched SHR's management at the expense of shareholders (Eisen, 2013).

OC suggested to the company to form a special committee of independent directors and hire a financial adviser to overhaul existing governance and explore all strategic alternatives, including a sale. In the event of failing to deliver the above, OC suggested that the independent directors should be replaced. OC also urged shareholders to withhold votes for four of the company's 10 directors at the company's 2012 Annual Meeting, including its CEO. SHR's Board in turn rejected the suggestions and responded that it strongly disagreed with OC's assessment (NY Business Journal, 2013b).

OC was trying to convince SHR to liquidate its luxury properties, and its efforts were merely '*a function of math'* according to The Wall Street Journal. SHR's shares were trading between \$5.44 and \$8.11 over the previous 52 weeks before March. OC strongly believed that selling the entire portfolio would produce proceeds of \$11 to \$14 a share, a view that analysts shared too (Hudson, 2013a). Daniel Lewis, OC's managing partner, in an interview, criticised SHR stating that the company did not have a concrete plan to close the gap between the current share price and the company's private market value (Hudson, 2013a).

In contrast, SHR's management argued that it had a plan to increase the company's value. SHR's CEO, in an interview, mentioned that the company could increase its share due to the reason that its conference business was improving; net operating income was rising, and it had reduced $1.4 billion of its debt. For Gellein and for SHR's major shareholders, putting the company up for sale was not the best way to increase the value of the company (Hudson, 2013a).

Eisen (2013) believed that OC did not have much leverage to force SHR to put itself up for sale. By that time, none of the other SHR major shareholders, including Cascade Investment LLC (Bill Gates' private investment arm), had publicly joined OC's cause. Although some large shareholders of the company agreed with OC's arguments, SHR's value would be even greater if sold, a year or two after Gellein had made further improvements. The potential sale looked attractive as SHR's properties formed a potentially good fit for private buyers. In addition, the sudden departure of Geller and Gellein's less personal attachment to the company were signs of a potential sale (Hudson, 2013a). Indeed, there were signs that Gellein was keeping options open for a disposal of part or all of SHR's properties. The company had ensured, by refinancing mortgages on some of its properties, that any new owner could assume the debts.

On 20 May, SHR's Board of Directors had approved an amendment to the company's shareholder rights plan (poison pill) to accelerate the expiration date from 30 November 2013, but no later than 14 June 2013 (SHR, 2013b). The shareholder rights plan was one of the governance concerns that OC highlighted in its public statement on 19 February. OC further noted that SHR's revised Corporate Guidance Guidelines contemplated that a shareholder rights plan could be re-instated without requiring a shareholder vote for up to twelve months. OC believed that the option to re-instate the poison pill could undermine any possible sale process. The fund also addressed the fact that SHR still had numerous deficiencies (see Appendix 2) in its business strategy and corporate governance (Business Wire, 2013b).

In June, reports surfaced that SHR had put itself up for sale to appease OC (NASDAQ, 2015). According to speculations, the company had hired Eastdil Secured, an investment bank (subsidiary of Wells Fargo), to explore a potential sale of the company. However, Diane Morefield, SHR's Chief Financial Officer later declined to comment (Hudson, 2013b; Jonas, 2013). Although SHR's potential sale was never confirmed by any of its executives, there were signs that changes were about to occur in the short term. OC remained troubled that SHR had failed to confirm public reports stating that they had retained a financial advisor to pursue a potential sale of the company (Hotel News Resource, 2013b). On 16 July, OC sent a letter (see Appendix 3) to SHR's independent directors expressing their disappointment about the uncertainty that SHR created within the market for the company's shares. The fund believed that the potential sale process was neither transparent nor appropriately disclosed. In addition, SHR's poor corporate governance history was a further reason for OC to retain its own financial advisor (Gallun, 2013; Market Watch, 2013).

On 20 November, OC issued a press release announcing its intention to nominate four independent directors to SHR's Board for election at the 2014 Shareholders Annual General Meeting. The fund believed that the nominated directors would offer significant experience in hotel operations, industry dynamics and capital markets. Additionally, OC established a website that provided SHR's shareholders with a presentation outlining the fund's independent perspectives on SHR. The last point that was featured on the press release was OC's intention to retain Okapi Partners LLC as proxy solicitor for the SHR campaign (Business Wire, 2013c).

One of SHR's objectives was to reduce its debt of $1.4 billion. SHR's agreement to sell the Four Seasons Punta Mita Resort, one of the greatest real estate assets of the company and 48 acres of land adjacent to Cascade Investment, LLC, intensified the pressure from the shareholder activist. OC expressed its shock and outrage at the sale of the resort calling it a '*serious violation of investor trust*'. Analysts believed that the sale meant that OC would not be able to count on Cascade's support for its dissident director candidates at the annual meeting (Alva, 2015; Orol, 2013; Tekippe, 2013). The sale of the Mexican resort, as well as its London hotel (the Grosvenor House) in 2014 generated cash flow that was critical for reducing SHR's debt and expanding in the US market by focusing on new acquisitions. SHR's response to OC's release was immediate and emphasised the fact that the Board and the management of the company continually reviewed options to create value for their shareholders. SHR believed that the sale of the Punta Mita resort and the adjacent land for a gross value of $200 million was excellent value and provided an opportunity to de-leverage the company's balance sheet (SHR, 2013c).

On 20 December, following SHR's response, OC sent a letter to Sheli Rosenberg, SHR's lead independent director arguing that the sale process had been insufficiently marketed, having been exclusively negotiated with a major shareholder. OC charged SHR with '*value destroying governance practices*' including problematic executive compensation; excessive corporate expenses – as a percentage of total revenue – and shareholder unfriendly defences owing to the fact that SHR did not hire an independent financial advisor to evaluate the sale of the resort. Eventually, the deal closed in February 2014, with SHR insisting that it was a fair one (Alva, 2015).

5.4.2 Period II: January 2014 - May 2014

Following the sale of the resort, SHR, in a press release on 7 March announced that it had reached an agreement with OC and agreed to appoint David W. Johnson to the company's Board. With the addition of Johnson, SHR's Board expanded to 10 members, nine of whom were independent and all of whom were elected annually. In turn, OC had withdrawn its notice of nomination of the remaining director candidates to the SHR's Board and had agreed to vote its shares in favour of each of the company's nominees at the 2014 Annual Meeting. Furthermore, OC agreed to a customary standstill provision (Gallun, 2014; SHR, 2014). OC pointed to some positive measures taken by SHR, including an independent review of executive compensation and redemption of the company's Series A Preferred Stock (Alva, 2015). OC held SHR's shares (total value of $28 million) up until 15 May 2014 (latest filing report) (SEC, 2014) and shortly after that period, the fund sold its stake in SHR (Alva, 2015). On 19 May, SHR's share price was $10.78 per share, while on the 25 August, it reached $11.86 per share. (Amigobulls, 2017; Gurufocus, n.d).

5.4.3 Post-Activism Period

In 2014, SHR's revenues amounted to $1.09 billion while net profit was approximately $344.4 million and within the same year, its share price demonstrated a 40% increase. Lukas Hartwich, an analyst with Green Street Advisors, believed that even without paying dividend to its shareholders, SHR had outpaced the overall lodging and resort industry over the previous three years (NASDAQ, 2015). In the meanwhile, SHR's margins were steadily moving up and in the third quarter of 2014, the company's

EBITDA[9] margin was 27%, up from 24.1% in the same quarter two years prior. In 2014, SHR sold two of its hotels in London and in Mexico with the intention of focusing on the US market. Within the same year, the company acquired the Montage Laguna Beach (Mueller, 2015), the Four Seasons Resort Scottsdale, and acquired their partners' interest in Hotel Del Colorado and the Fairmont Scottsdale Princess in Arizona (PR Newswire, 2015a).

On 8 September 2015, SHR was acquired by the Blackstone Group for approximately $6 billion – including debt. On 11 December 2015, SHR announced the completion of the acquisition of the company by affiliates of Blackstone Real Estate VIII L.P. Holders of SHR's shares were entitled to receive $14.25 in cash for each share they owned. Because of the transaction, SHR's shares ceased trading on the NYSE (PR Newswire, 2015b). Almost a year later (27 September 2016), Blackstone sold the company to Anbang Insurance Group for approximately $6.5 billion (Yu, 2016).

5.5 Summary

This chapter has presented the research findings emerging from the online documentary information and investigation of shareholder activism in SHR. The sole shareholder activist, OC, exerted significant pressure on SHR's Board by urging the sale of the REIT over a 14-month period. To achieve this, OC focused on SHR's poor corporate governance, undervalued portfolio and financial instability of SHR's operating and financial results from 2006-2014 which was a result of the crash of the housing market in the US in 2007. SHR's poor performance was in line with the

[9] Stands for earnings before interest, taxes, depreciation and amortisation. It is one indicator of a company's financial performance and is used as a proxy for the earning potential of a business.

challenges that most REIT's and SHR's competitors faced in the aftermath of the financial crisis.

OC engaged in a number of public disputes with SHR related to the future of the company. Shareholder activism increased the pressure on the company's Board for sale of the company and battles between the two parties were frequent. OC was the winner in the feud with SHR as they managed to place a representative on the company's Board and they made a profit on their investment to SHR after they sold their stake, showing one of the faces of shareholder activism which is to increase their return on investment. The next chapter presents the intervention of two shareholder activists on another 'target'.

CHAPTER SIX - CASE STUDY II INTERCONTINENTAL HOTELS GROUP

6.0 Introduction

The aim of this case study is to discuss and analyse Trian's Fund Management, L.P. (TFM) and Marcato's Capital Management (MCM) investment and activism targeting Intercontinental Hotels Group PLC (IHG). Both entities made several interventions in IHG over a three-year period (2012-2015). During their activism, both TFM and MCM believed that IHG could be a takeover target and would be more valuable if acquired by a competitor.

After two turbulent activism periods, IHG did not become a takeover target and remained a standalone company. During the activism period, the company strengthened its portfolio by acquiring small companies such as Kimpton Hotels and Restaurants, by opening new properties globally and by launching new hotel brands such as Indigo, Avid Hotels, Hualuxe Hotels and Resorts and Voco.

6.1 The Players

The Target

IHG is a global hotel company based at Denham, UK. It is one of the world's leading hotel companies with more than 350,000 people working across almost 100 countries. IHG's portfolio consists of 15 hotel brands and includes over 5,903 hotels and 883,563 rooms, while the group has under development 1,918 hotels in its pipeline with 283,043 rooms (IHG, 2020a).

IHG's business model mainly focuses on franchising and managing while their business partners own the physical assets. The company has 4,870 hotels under franchise agreements, 1,007 hotels under management contracts and the group's owned and leased hotels are twenty-six. Overall, 72% of the group's operating profit is generated by franchised agreements and 28% by owned, leased and managed lease assets. IHG focuses on an asset-light business model supported by a long term-approach to allocate capital and reduce the asset intensity of the business (IHG, 2020b).

IHG's story dates to 1777 when William Bass opened a domestic brewery in Stoke on Trent, UK. After several acquisitions and ownership structures over the past two centuries, in 2003 IHG became a standalone company in a demerger from the brewing and pub company. Notable developments in the company include the launch of a boutique hotel brand, Indigo, the launch of a hotel brand, Even Hotels, that focuses on healthy travel, the launch of an upscale brand, Voco, and a hotel brand, Hualuxe Hotels & Resorts, designed for Chinese travellers. Furthermore, in 2015, IHG completed the acquisition of a US-based hotel company, Kimpton Hotels & Restaurants and in 2019 acquired a top tier luxury brand, Six Senses Hotels Resorts Spas (IHG, 2020c).

Financial Performance 2006-2015

As of 19 March 2020, IHG's market capitalisation was £6.75 billion (Financial Times, 2020). Similar to the SHR case, IHG did not escape the financial crisis, which hit the global hotel industry. In October 2008, the company's shares fell more than 5% due to weakening conditions. The group's revenue per available room fell 4.5% in October

2008; however, operating profits at the time were ahead of expectations, as there was a growth of 8% to $153 million in the three months to the end of September 2008 and the revenues rose 7.3% to $486 million. Despite the latter positive results, IHG's pre-tax profits fell 19.8% to $89 million (Scotsman, 2008; Sibun, 2008).

Overall, IHG's revenues (see Table 6.1) decreased considerably by 17% from 2008 to 2009 because of the financial crisis. From 2009-2016, IHG's revenue demonstrated changes, positive and negative, ranging from 6% to -5% change. Although the company's net income was positive throughout the same period, it showed considerable fluctuations. For example, from 2006 to 2009 IHG's net income decreased by almost $500 million, while after this period, the net income gradually recovered over several years and reached approximately $1.2 billion in 2015. In 2015, profit increased primarily due to gains from the sale of the InterContinental Paris-Le Grand and InterContinental Hong Kong (IHG, 2015a).

Table 6.1 IHG Revenue and Net Income Year 2006-2016

Year	Revenue ($)	Revenue Change %	Net Income ($)	Net Income Change %
2006	1,446,000,000		754,000,000	
2007	1,771,000,000	22%	463,000,000	-39%
2008	1,854,000,000	5%	262,000,000	-43%
2009	1,538,000,000	-17%	214,000,000	-18%
2010	1,628,000,000	6%	280,000,000	31%
2011	1,768,000,000	9%	473,000,000	69%
2012	1,835,000,000	4%	545,000,000	15%
2013	1,903,000,000	4%	374,000,000	-31%
2014	1,858,000,000	-2%	392,000,000	5%
2015	1,803,000,000	-3%	1,224,000,000	212%
2016	1,715,000,000	-5%	591,000,000	-52%

Source: SEC (2008a) Form 20-F [Online]. Available at: https://www.sec.gov/Archives/edgar/data/858446/000115697309000202/u06009e20vf.htm [Accessed 18 July 2015]. SEC (2013) Form 20-F [Online]. Available at: https://www.sec.gov/Archives/edgar/data/858446/000119312513126680/d423471d20f.htm [Accessed 18 July 2015]. SEC (2016a) Form 20-K [Online]. Available at: https://www.sec.gov/Archives/edgar/data/858446/000119312516490850/d76057d20f.htm#tx76057_17 [Accessed 18 July 2017].

Prior to the sale of its hotels in Paris and Hong Kong, IHG had completed the sale of the InterContinental London Park Lane in May 2013, the InterContinental New York Barclay in December 2013 and the InterContinental Mark Hopkins in February 2014 (Lin, 2014), transactions that supported the group's asset light strategy. An important aspect of IHG's asset light strategy was the sale of 183 hotels for $5.5 billion from April 2003 to November 2008. The asset light strategy had protected IHG during the financial crisis from plummeting property values. However, an analyst noted that despite IHG's business model, the company would be unable to avoid the fallout from a global fall in demand for hotel rooms at the time (Sibun, 2008).

Following an overall good share performance in 2007 (reaching $38.58 per share in May), IHG's shares had lost 70% of their value during 2008, although the company remained one of the better performing listed hotel companies at the time (Evans, 2008). The decreasing pattern of the share price continued in February 2009, where it hit an all-time low of $8.30 per share amid the financial crisis. After 2009 and up to the beginning of August 2017, IHG's share price started to rise, despite two periods in 2012 and 2016 when the share price had dropped considerably leading to a negative percentage change of -12% and -17% respectively (see Table 6.2).

Table 6.2 IHG Share Price Performance 2006-2017

Date	$	% Change
01 January 2006	25.88	
01 January 2007	36.47	41%
01 January 2008	18.67	-49%
01 January 2009	8.51	-54%
01 January 2010	17.19	102%
01 January 2011	25.66	49%
01 January 2012	22.49	-12%
01 January 2013	33.08	47%
01 January 2014	37.00	12%
01 January 2015	41.87	13%
01 January 2016	34.67	-17%
01 January 2017	48.12	39%
01 August 2017	56.91	18%

Source: Seeking Alpha (2017a) IHG [Online]. Available at: https://seekingalpha.com/symbol/IHG/chart [Accessed 24 August 2017].

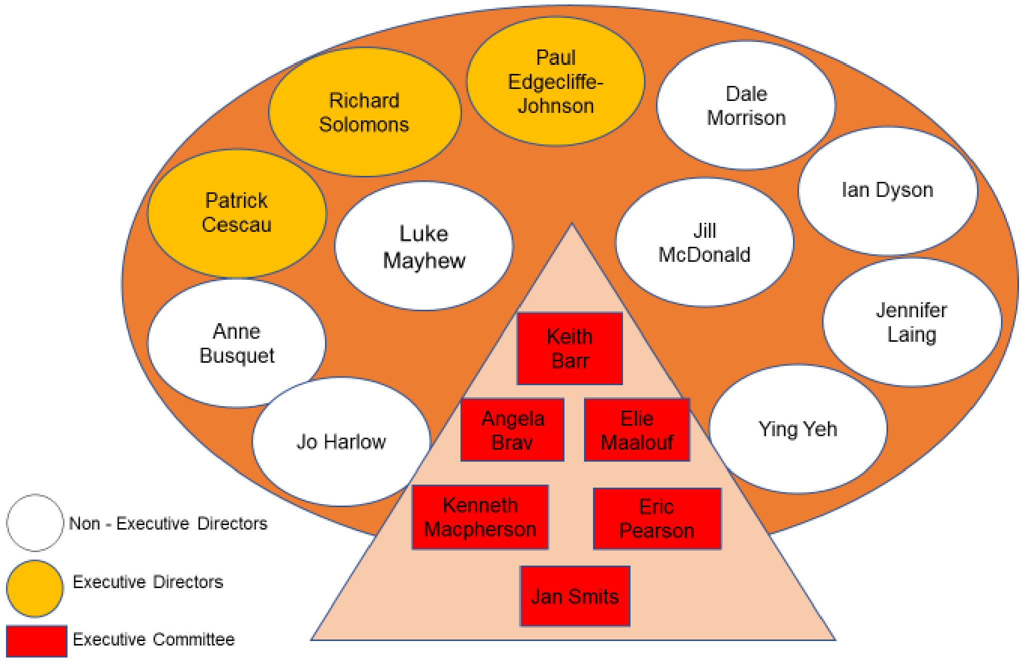
After January 2016, IHG's share price increased by approximately $22 and reached $56.91 per share up to the beginning of August 2017 which was the highest recorded price since 2006.

Leadership

Since 2006, IHG's corporate governance demonstrated stability in its Board and Executive Committees. From 2006 to the current date, three CEO's have led the company. More specifically: i) Andy Cosslett - February 2005 to June 2011, ii) Richard Solomons (IHG, 2011) - June 2011 to June 2017 and Keith Barr (IHG, 2017) - June 2017 to the current date.

Many of the executive and non-executive directors remained on the Board during shareholder activism. In 2015, IHG's governance structure consisted of executive and non-executive directors and an executive committee (see Figure 6.1). None of the Non-Executive Directors on the Board had any direct interest in the group other than their membership.

Figure 6.1 IHG Board of Directors as of 31 December 2015



Source: IHG (2015b) Our Board of Directors [Online. Available at: https://www.ihgplc.com/files/reports/ar2015/files/pdf/corporate_governance.pdf [Accessed 3 July 2017].

6.2 The Activists

Trian Fund Management (TFM) L.P. / Nelson Peltz

TFM is an investment management company that combines concentrated public equity ownership with operational expertise. According to its website, TFM is a '*highly engaged shareowner*' that seeks to invest in high quality but undervalued and underperforming public companies. The company aims to work together with management teams and Boards to execute operational and strategic initiatives designed to drive long-term earnings growth for the benefit of all shareholders (Trian Partners, 2017a). It's CEO and one of its founding partners is Nelson Peltz, a preeminent figure in the US investment community and a well-known activist investor. Peltz is famous for turning companies around and returning value to investors and shareholders. Two of the most famous examples of his strategic investments are the H.J. Heinz Company in 2006 and the Wendy's Company in 2008. Both companies benefited from his interventions and both retained him on their Boards during his investment (Shea, 2012). Peltz is also well known for being the driving force behind the demerger of Cadbury Schweppes in 2007, which left the chocolate brand vulnerable to assault by US food giant Kraft (McLachlan, 2008; Thomas, 2012).

TFM's portfolio as of December 2019 was valued at approximately $9.5 billion and its investments included companies in several industries. Its most recent investments consisted of large companies that are household names and generate billions in annual turnover – Procter & Gamble Co, Mondelez International Inc., General Electric Co –. As of December 2019, half of TFM's portfolio were companies from the consumer goods industries (Insider Monkey, 2020).

TFM invested in IHG in the second quarter of 2012. In its third quarter filings, 30 September 2012, TFM's investment portfolio consisted of several companies (see Table 6.3) that are presented in order according to their holding value. Apart from IHG, TFM's former investments include companies such as Heinz, Tiffany & Co, Kraft Foods, PepsiCo and Danone.

Table 6.3 TFM Investment Portfolio as of 30th September 2012

Company	Industry	Number of Shares	% of share hold	Value ($)
INGERSOLL RAND PLC	Industrial Manufacturing	13,470,668	17.18	603,756,000
FAMILY DOLLAR STORES INC	Retail	8,967,564	16.92	594,549,000
STATE STREET CORP	Financial Services	9,140,107	10.91	383,519,000
WENDYS CO	Restaurants	83,000,245	10.69	375,576,000
KRAFT FOODS INC	Food Manufacturing	8,131,787	9.57	336,249,000
LEGG MASON INC	Asset Management	12,884,337	9.05	317,985,000
LAZARD LTD	Financial Services	5,598,980	4.65	163,658,000
TIFFANY & CO	Jewellery & Speciality Retailer	1,004,151	1.76	62,137,000
HEINZ H J CO	Food Manufacturing	106,500	0.16	5,959,000

Source: Insider Monkey (2017b) Trian Partners – Holdings [Online]. Available at: https://www.insidermonkey.com/hedge-fund/trian+partners/163/holdings/#/ffp=2012-09-30&fot=7&fso=2&pfp=-1&fundType=0 [Accessed 12 August 2017].

In May 2012, TFM bought a 4.27% stake in IHG and traders in London at the time believed that the company's future would be bright with Peltz involved (Shea, 2012). Investors believed that Peltz would shake up IHG's strategy and support its market value, while other investors were betting that Peltz had found another of his favourite targets, a company that had valuable brands, but whose operational management of their assets required improvement. IHG's shares had previously underperformed those in its peer group such as Marriott International and Starwood Hotels & Resorts Worldwide two years before TFM decided to enter the group (Foley and English, 2012; Werdigier, 2012).

According to information listed on its website, TFM was attracted to the favourable supply and demand backdrop within the hotel industry in 2012 – the US economy was driving room demand while the number of new rooms under construction was at record low levels. TFM believed that IHG's full value was not reflected in the stock valuation.

In addition, the fund believed that IHG was trading at a substantial discount to intrinsic value as a predominantly asset-light firm (Trian Partners, 2017b). After a series of interventions, TFM exited IHG in early 2013, only seven months after its entry into the hotel company.

Marcato Capital Management (MCM)

MCM is a hedge fund based in San Francisco, California, that was founded by Richard McGuire. The fund provides its services to pooled investment vehicles, it invests in value shares and employs a fundamental analysis to make its investments (Bloomberg, 2017a). MCM invests primarily in small- and medium-sized companies primarily in the services and consumer goods industries. Its total portfolio as of 30 September 2019 was valued at approximately $127 million representing a sharp decline from December 2014 where it was valued at approximately $3.05 billion. More than half of MCM's portfolio were companies from the services sector (Insider Monkey, 2019).

MCM invested in IHG in the second quarter of 2014. In its second quarter filings, 30 June 2014, MCM's investment portfolio consisted of several companies (see Table 6.4) that are presented in order according to its holding value. MCM's former investments include companies such as Sotheby's, Avis Budget Group and Vall Resorts.

Table 6.4 MCM's Investment Portfolio as of 30 June 2014

Company	Industry	Number of Shares	% of share hold	Value ($)
NCR CORP	Technology	10,850,488	20.09	380,744,000
GOODYEAR TIRE AND RUBBER CO	Manufacturing	10,966,078	16.08	304,638,000
AMERICAN REALTY CAPITAL PROP INC	Real Estate	21,784,075	14.4	272,954,000
MACQUARLE INFRASTRUCTURE CO LLC	Aerospace, Oil & Gas, Bulk Liquid Storage	3,866,126	12.72	241,130,000
SOTHEBYS	Auctioneering	4,637,991	10.27	194,749,000
LIFE TIME FITNESS INC	Health Clubs	3,115,167	8.01	151,833,000
AVIS BUDGET GROUP INC	Mobility Solutions	2,050,020	6.45	122,376,000
VALL RESORTS INC	Hospitality	1,508,063	6.14	116,392,000
LEAR CORP	Automotive Systems	1,099,682	5.18	98,224,000
BROOKFIELD RESIDENTIAL	Real Estate	552,535	0.6	11,464,000

Source: Insider Monkey (2017e) Marcato Capital Management – Holdings [Online]. Available at: https://www.insidermonkey.com/hedge-fund/marcato+capital+management/376/holdings/#/ffp=2014-06-30&fot=7&fso=0&pfp=-1&fundType=0 [Accessed 11 August 2017].

In 2013, MCM was named the US equity hedge fund of the year and its founder and CEO, Richard McGuire, was named by the Institutional Investor as Emerging Fund Manager of the Year. These accolades were a result of the fund's good performance, producing investment returns of more than 26% in both 2012 and 2013 (Robinson and Massoudi, 2014a). McGuire started MCM in 2010 with financial backing from Blackstone having previously worked at Pershing Square Capital Management (a leading US hedge fund) (La Roche, 2013). The fund came to prominence when it took a large stake in the auction house Sotheby's and encouraged it to return more cash to shareholders (Robinson and Massoudi, 2014b). The firm disclosed its stake (3.8%) in IHG during May in 2014 and exited its investment in August/September 2015.

6.3 Case Overview

Prior to presenting the case, it is important to note the period over which each shareholder activist bought and sold IHG's shares (see Table 6.5). This case presents the events in chronological order to illustrate the intervention of the activists on IHG's Board.

Table 6.5 Shareholder Activists' Investment Overview

Shareholder Activist	Date bought shares	% of common stock in MHG	Date sold shares
Trian Fund Management	May 2012	Approximately 4.27%	February 2013
Marcato Capital Management	May 2014	Approximately 3.8%	August/September 2015

Both activists exerted considerable pressure on IHG to consider a takeover bid on two separate occasions; however, they did not stay in the company for a long period. Following MCM's exit, IHG did not encounter further activism interventions.

6.4 Shareholder Activism Events

This section presents how the events unfolded during the activism period and involved all players in the case. Prior to presenting the events, this case study presents an overview of key events that occurred in IHG during the activism period (see Table 6.6) in order to enable the reader to have a thorough view of the case.

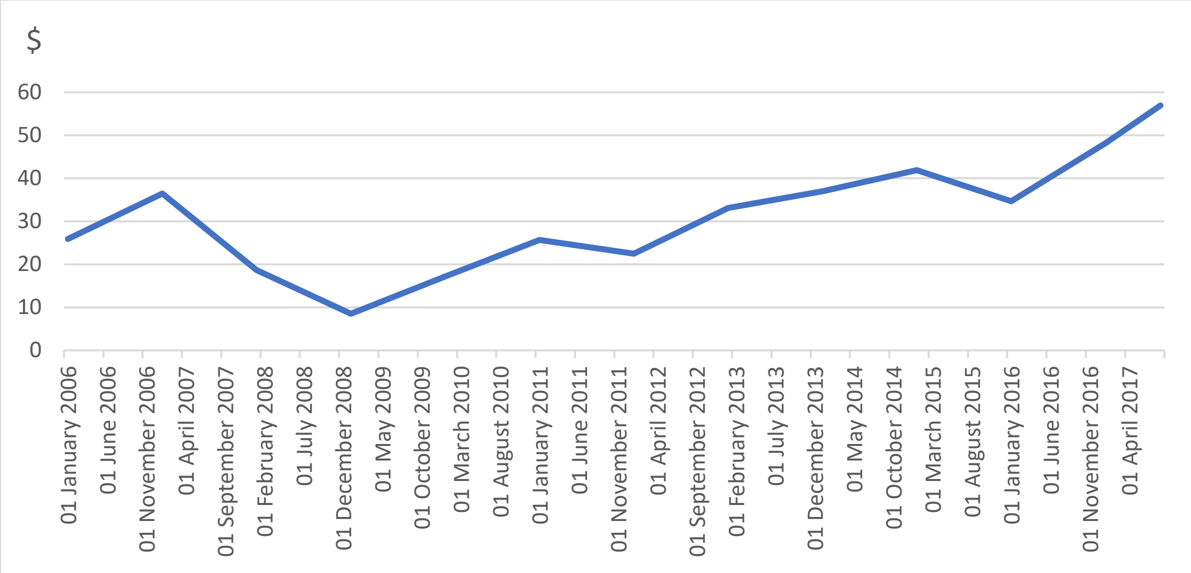
Table 6.6 Overview of Key Events during the Shareholder Activism Period

Dates	Event
2012	
May	TFM announced that they had bought a 4.27% stake in IHG and had become the fifth largest shareholder in the company at the time.
May	IHG's share price rose by almost 6% on the same day as the stock bought by TFM.
2013	
January	TFM had reduced its holding to IHG to less than 1%.
2014	
May	IHG rejected a £6bn bid from an undisclosed U.S. suitor.
29th May	MCM revealed itself as one of IHG's biggest shareholders that owned 3.8% ($400m investment) and called on IHG to seriously consider a takeover bid.
4th August	MCM announced that it had hired advisers at Houlikan Lokey to find a US buyer for a strategic review of IHG in order to enhance shareholder value.
11th November	MCM released a letter to IHG shareholders along with a detailed presentation outlining the results of an independent evaluation of various potential strategic alternatives conducted by Houlikan Lokey.
15th December	IHG acquired Kimpton Hotels & Restaurants for $430 million.
18th December	Berenberg had issued a buy note with a £27.50 price target, stating that IHG could merge or take over Hyatt.
2015	
July	IHG agreed to sell another large trophy hotel - the InterContinental Hong Kong - for $938 million.
July	IHG had held early stage merger talks with Starwood Hotels & Resorts Worldwide Inc. to create the world's largest hotel group.
September	MCM sold most of its 4 per cent shareholding in IHG and sources close to the situation had suggested that MCM was not an investor in the company.

6.4.1 Period I: January 2012-December 2013

As mentioned previously, the financial crisis negatively influenced the global hotel industry and IHG's share performance was not an exemption (see Figure 6.2).

Figure 6.2 IHG Share Price Year 2006 - 2017



Source: Seeking Alpha (2017a) IHG [Online]. Available at: https://seekingalpha.com/symbol/IHG/chart [Accessed 24 August 2017].

After a considerable drop in the share price during the financial crisis, IHG's share price started to recover leading to a peak of $22.56 per share in January 2011. However, for almost a year (January 2011 to January 2012) the share price continued to decrease. During the second quarter of 2012, TFM announced that they had bought a 4.27% stake in IHG ($33.36 share price value as of 14 May 2012) and had become the fifth largest shareholder in the company. Traders in the London market believed that Peltz, who had been successful in the activism arena by forcing changes in public companies, would benefit IHG who was underperforming compared to its peers (Shea, 2012).

TFM's move sent IHG's share price up almost 6% within one day, stoked takeover speculations and increased shareholders' hopes that TFM's involvement would maximise shareholder value (Shea, 2012). Asked whether he was worried about TFM's and Peltz's move, Solomons (CEO of IHG) stated that the fund and its founder had a track record of investing in companies that create value, and anybody could buy and sell IHG's shares – TFM are just another shareholder – (Steiner, 2012).

Analysts believed that Peltz would probably be looking to push IHG to sell more of its owned and operated hotels. Wyn Ellis of Numis Securities (a financial advisory firm) shared another view concerning TFM's move and said that: '*Consolidation is inevitable at some stage. IHG, trading at an apparently perpetual discount to its US peers, looks like a possible consolidate*' (Foley and English, 2012; Reuters, 2012; Thomas, 2012). The first big consolidation of the global hotel industry occurred in November 2015 with Marriott's acquisition of Starwood Hotels and Resorts.

On 19 February 2013, IHG confirmed that TFM had reduced its holding in the company to less than 1% and shortly after this period, the fund exited the group ($39.98 share price value at 4 March 2013) (Walsh, 2013). According to the Hotel Analyst (2013b), IHG's shares had a strong run between January 2012 and January 2013 and TFM profited by reducing its holding. Over the course of TFM's investment, IHG made progress in monetising its real estate assets, culminating in the sale of assets equivalent to approximately 10% of IHG's market capitalisation. In 2013, IHG also delivered a 26% total return to investors and the company kept buying back stock: they had completed the latest $500 million repurchase on 29 May 2013 (Elliott, 2014). In addition, over a decade the company handed back to shareholders more than £10 billion in dividends (Fletcher, 2014a; Robinson and Massoudi, 2014b).

6.4.2. Period II: January 2014-December 2015

In May 2014, IHG rejected a £6 billion bid from an undisclosed US suitor. According to Kleinman (2014) Wyndham Worldwide Corporation (WYN) made a preliminary offer to acquire IHG. WYN was examining a merger with IHG in order to pursue a tax inversion, under which its tax domicile (US) would have switched to the UK that provided favourable corporate tax rates. Shortly after IHG's rejection of the bid, MCM revealed on 29 May 2014 that it was one of IHG's largest shareholders (the fifth largest) through its ownership of 3.8% (a $400 million investment on £50.60 share price value as of 19 May 2014) and called on the company's management to seriously consider a takeover bid. In a statement, the fund said that the '*prospect of a merger with a larger hotel operator would have compelling strategic and financial merit and would reshape the hospitality industry*' (Ide, 2014; Robinson and Massoudi, 2014b).

The fund encouraged IHG's Board to explore such an option and engage advisors to conduct a formal process to ensure it evaluated the full range of opportunities available to maximise value. The takeover speculation left IHG's shares trading at an all-time high (Robinson and Massoudi, 2014b). IHG remained silent on the bid rumours during the summer. On 4 August 2014 and one day before IHG unveiled its half-year results to the City, MCM announced that it had Houlikan Lokey (an advisory bank) to find a US buyer for a strategic review of the business in order to enhance shareholder value (Onge and Brandt, 2014). MCM's review would focus on various alternatives including, but not limited to, improving capital structure and/or capital allocation and strategic transactions. The fund believed that the market conditions at the time could significantly enhance IHG shareholder value, something that would not be available in the future (Bray, 2014; Maidment, 2014). MCM said at the time that it intended to engage in direct dialogue with IHG's Board, IHG shareholders and industry participants (Zagger, 2014).

IHG did not comment on the reported takeover offer or on MCM's statements and the next day, announced its half-year results. MCM's pressure intensified after mixed results and despite the 6% increase in underlying profits, IHG's operating profits and revenues were down by 8% ($310 million) and 3% ($908 million) respectively. The company's shares fell by almost 3% to 2,290p on the day results were disclosed, having fallen steadily since the record high of 2,475p on 24 July (Savage, 2014). IHG increased its half-year dividend by 9%, to 25 cents per share; however, the payment of the $750 million special dividend in May 2014 pushed the company's net debt to about $1.8 billion – up from $1.03 billion at the end of June (Armstrong, 2014a; CNBC, 2014; Robinson and Massoudi, 2014a).

On 11 November 2014, MCM released a letter to IHG shareholders that included a 77-page presentation outlining the results of an independent evaluation of various potential strategic alternatives conducted by Houlikan Lokey (Armstrong, 2014b). MCM publicly released its analysis because IHG's Board had dismissed the fund's suggestion to merge with a larger operator. MCM stated that in order to ensure the Board and IHG's shareholders were acting responsibly and in the interests of all IHG shareholders, they made the analysis available on a website that they had created – www.IHGvaluecreation.com – (the website has since been taken down) (PR Newswire, 2014). After the analysis was made publicly available, IHG's share price jumped 3% to $40.36 (Brandt, 2014; Herbst-Bayliss, 2014). The fact that IHG had dismissed previous suggestions by MCM to explore strategic alternatives, led the fund to decide to build its stake further. It suggested that the Board '*was not giving due consideration to the strategic alternatives available in the industry and M&A environment*'. According to MCM, IHG had neither solicited offers nor performed the rigorous analysis necessary to evaluate potential share-enhancing options (Brandt, 2014; Herbst-Bayliss, 2014; PR Newswire, 2014).

After receiving Houlikan Lokey's evaluation, MCM concluded that on a standalone basis, IHG would not be able to provide shareholder value compared to what could have been achieved if it combined with another major hotel operator (PRNewswire, 2014). MCM argued that an equity combination with a major hotel operator could deliver a premium upwards of 100% over IHG's share price at the time, creating a powerful and diversified hotel management company (Herbst-Bayliss, 2014). Most importantly, in the event of a transaction, IHG's shareholders would maintain ownership of any combined entity, therefore enabling MCM to participate in the long-term upside of the larger company (Armstrong, 2014b; PR Newswire, 2014). MCM further added that there would be synergies and growth opportunities through the expanded scope and scale of the business (Brandt, 2014). In its public presentation, MCM presented a timeline of IHG's share price from January 2014 up to September of the same year that shows a considerable increase in IHG's share price since MCM's intervention in the company (see Figure 6.5). On March 2014, when MCM begun purchasing IHG shares, the price per share was valued approximately at £18.30. Following several MCM interventions over the next months, the price per share was valued approximately at £23.80.

Figure 6.3 IHG Share Price January 2014-September 2014

Source: SlideShare (2016) Marcato Capital - IHG September Board Presentation [Online]. Available at: https://www.slideshare.net/RyanMartin57/marcato-capital-ihg-september-board-presentation [Accessed 14 August 2017].

The above timeline of IHG's share price intended to influence IHG's Board and shareholders, therefore intensifying the pressure on the company. In its presentation, MCM indicated that Houlihan Lokey's research highlighted key points.

The first point the fund highlighted on their presentation was the potential contribution of the global M&A market growth to the Board's urgency (abundance of low-cost financing and increased cross-border activity). Justifying its statement, MCM referred to record-low interest rates and improved business confidence in the global M&A market. The fund referred to the increasing desire for geographic diversification as well as the intensifying search for revenue growth and expense efficiencies (Hotel Analyst, 2014).

The second point was related to the existence of latent interest from several potential industry partners. Numerous diverse business combinations could deliver permanent value creation for IHG shareholders as owners in a new hospitality company. MCM's presentation noted that a combination with any of the main three – Starwood, Marriott or Hilton – would create the largest and most valuable hospitality company in the world. A combination with any of these strategic partners had the potential to: i) create a powerful and diversified hotel management company with significant global scale, ii) enable revenue synergies expanding their loyalty programme, iii) allow for potential cost and tax efficiencies, iv) serve as a catalyst to reach optimal capital structure targets. Concluding the key points MCM advised IHG to hire an independent financial advisor and conduct a full and formal evaluation of strategic alternatives and their impact on shareholder value stressing the timing of that period (Hotel Analyst, 2014).

In response to MCM's public presentation, IHG issued a statement and said that they had met MCM twice (22 September 2014 and 20 October 2014) and reviewed the fund's analysis. Following the review, the Board concluded that it remained in the best interests of its shareholders to pursue the company's strategy for quality growth and by delivering operational and financial performance (IHG, 2014).

On 18 December, after IHG's response to MCM, Berenberg (a private banking company) issued a buy note with a £27.50 price target and said that IHG could merge or take over another hotel company, but was more likely to be the ‘prey rather than the predator’, with Starwood or Hilton the most obvious acquirers. In their statement, Berenberg concluded that on a standalone basis, IHG was fully valued and consolidation should be inevitable. During the same week, IHG acquired Kimpton Hotels & Restaurants for $430 million, but Berenberg believed that it would take a much bigger deal for IHG to retain its independence. Berenberg conducted a detailed analysis and concluded that IHG should consider merging or acquiring Hyatt (or other small players). However, according to Berenberg, IHG was likely to be the prey in industry consolidation and an offer of £29 to £30 should secure management approval (Fletcher, 2014b). It is worth noting that amid MCM’s pressure to change course, IHG continued to sell its large trophy hotels, including the sale of Paris Le-Grand to Constellation Hotels for $405 million (Holton, 2014).

In July 2015, IHG had agreed to sell another large trophy hotel – InterContinental Hong Kong – for $938 million to fend off the attention of circling activist investors. The sale of the hotel raised hopes at the time of further returns to shareholders after IHG pledged an 11% boost to its dividend in February 2015. IHG had returned more than $1bn to shareholders in 2014, including a $736m special dividend in May 2014 after an informal takeover approach and the sale of two hotels (Fox, 2015; Martin, 2015; Paton and Thomas, 2015). On July 2015, it was revealed that IHG had held early stage merger talks with Starwood Hotels & Resorts Worldwide Inc. The informal talks were tentative, and Starwood could choose another suitor to pursue another strategy at the time. IHG said in a statement that the company was not ‘*in talks with Starwood with a view to a combination of the businesses*’ (Shanahan, Fahmy and Johnson, 2015). IHG’s CEO, Richard Solomons declined to comment on the merger talks as the company reported a 21.5% rise in first-half pre-tax profits to $458 million and he added that IHG's strategy was to grow organically. He further added that 't*here is a lot of noise around consolidation. If you look back a few years back it was real; now it is effectively organic*' (Massoudi, Moore and Fontanella - Khan, 2015).

IHG, according to Solomons, had achieved extensive organic consolidation as the company had signed more deals in the first half of 2015 than at any time since 2008. The company was building new brands and buying brands such as Kimpton Hotels & Restaurants (Massoudi et al., 2015). Shortly after the reporting of the talks by The Financial Times, IHG shares surged 4.6% (Massoudi et al., 2015; Shanahan et al., 2015).

In the beginning of September 2015, MCM had sold most of its 4% shareholding ($44.41 share price value as of 7 September 2015) in IHG and sources close to the situation had suggested that MCM was no longer an investor in the company. It was believed that the fund sold its stake following a denial by IHG of a report in late July 2015 that said that the company had held preliminary talks with Starwood Hotels & Resorts (Kleinman, 2015). Some sources believed that the surge of IHG's shares over the summer of 2015 led MCM to make its exit, by making a '*significant gain*'. However, it was suggested that underperformance of other MCM's top holdings over the summer led MCM to this move. More specifically, MCM had the majority of its portfolio invested in Bank of New York whose shares were down 8.3% in August 2015. Other notable holdings, Sotheby's and NCR were down 16% and 9% respectively for August (Seeking Alpha, 2015).

6.5 Summary

This chapter has presented the research findings emerging from the online documentary information and archival investigation of shareholder activism in IHG. Both shareholder activists, TFM and MCM, exerted significant pressure on IHG's Board over two different periods, in 2012 and 2014 respectively. Both activists believed that the company could be a takeover target and that it would be more valuable if a competitor acquired it. Interestingly, the activists did not follow the same tactics when entering IHG as shareholders. MCM was more '*vocal*' and took a more aggressive approach by engaging publicly with IHG compared to TFM who remained silent during their time in the company.

Despite shareholder activism on two separate periods, IHG remained a standalone company. However, both shareholder activists profited from their investments as their exit from the company allowed them to gain returns on their investment when IHG returned dividends to its shareholders, a tactic that shareholder activists apply in their targets. The next case study presents the struggle of the targeted company with four shareholder activists at the same period.

CHAPTER SEVEN - CASE STUDY III MORGANS HOTEL GROUP

7.0 Introduction

The aim of this case study is to discuss and analyse OTK Associates, LLC (OTK), Yucaipa Companies, LLC (YC), Kerrisdale Capital Management (KCM) and Rambleside Holdings LLC (RH) investment and activism targeting Morgans Hotel Group (MOR). All entities made numerous interventions to MOR's Board of Directors over an eight-year period (2008-2016). During their activism, all entities expressed the following intentions regarding MOR's future:

1. OTK's main intention was to assume full control of the Board. OTK's panel would seek to both grow the business and return MOR into profitability and evaluate and pursue strategic alternatives in a disinterested fashion.

2. YC urged both a sale process and increased transparency by the Board.

3. KCM wanted to take full control of the Board and believed that MOR should explore all strategic alternatives including the sale of the company at the time.

4. RH suggested steps for MOR to reform its corporate governance and urged the company to sell its hotels and management company separately.

Eventually, in late 2016 and after a long process, SBE Entertainment Group (SBE) acquired MOR. As part of the transaction, SBE received a significant investment from Cain Hoy Enterprises, a global real estate investment company. In addition, YC converted its stake at the time in MOR into an ownership interest in SBE. The other shareholder activists sold their shares to MOR at the end of September of 2016, after all MOR's shareholders approved the sale of the group to SBE, a transaction that paid each shareholder $2.25 per share.

7.1 The Players

<u>The Target</u>

In 1984, Ian Schrager[10] and Steve Rubell founded MOR when they opened the company's first hotel in New York. MOR grew by acquiring, redeveloping and operating assets initially in New York, in Miami and in Los Angeles. In 1997 and 1998, NCIC[11] acquired a majority interest in MOR in a series of transactions that resulted in the integration of the management, development and ownership parts of its business. In the following two years, from 1999 to 2001, MOR opened hotels in major cities – London, New York and San Francisco –, while in 2002, the company for the first time entered into a transaction when it acquired a minority interest in the Shore Club in Miami (SEC, 2006).[12]

SBE's portfolio of MOR brands currently consists of 11 properties and 2 properties under development and all of its hotels are in desirable urban and resort markets in the US, Europe and the Middle East. SBE's portfolio comprises four MOR brands (Delano, Mondrian, Hudson and Originals) (see Table 7.1) and 4,212 rooms (including those under development), that comprise banqueting space, restaurants, cocktail bars and spas (SBE - Morgans Hotel Group, 2020). SBE in their website lists another 11 hotels under development from MOR brands but with no additional information (number of rooms) rather than the location of the assets (SBE, 2020).

[10] Ian Schrager is considered as the Steve Jobs of the hospitality industry. He and his partner invented the boutique hotel concept with the Morgans hotel in 1984, a market that currently represents a $6.6bn market in the US (Mashayekhi, 2016A; Williams, 2017).
[11] NCIC was organised for the purpose of investing in real estate and real estate related companies. Its founders, Scheetz and Hamamoto served at MOR as president and CEO and chairman respectively.
[12] SEC (2006a) Form 10-K 2015 Annual Report [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000110465906021211/a06-6912_210k.htm [Accessed 15 June 2015].

Each hotel brand presents several distinctive characteristics that enable the group to gain an advantage over its competitors. MOR described itself as the global leader of the lifestyle hospitality sector, dedicated to building a differentiated brand portfolio and establishing their hotels in urban and resort markets.[13]

Table 7.1 MOR Brand Portfolio

Brand	Number of Hotels	Number of Rooms
DELANO		
Delano is the ultimate oasis of sensuality and soul, where sophistication and ease seamlessly blend with timeless design. Effortlessly chic and flirtatious, yet restrained in its simplicity, Delano is proof that the new rules of elegance are crisp, clean, and modern, without fuss or complexity.	2	1,311
MONDRIAN		
Mondrian is a place to see-and-be-seen. Here we believe in the perfect moment, where confidence reigns and perpetual possibility awaits. Intense, current, and playful, Mondrian is bold and brave, offering instant excitement the minute the door swings open - seductive and striking, and it's where glamour and fantasy prevail.	4	852
HUDSON		
Hudson is filled with exuberance and energy, social interaction and passion for life. It all begins in the lobby, the heart and soul of the hotel, where intriguing lives intersect, genuine conversations spark, and adventure and experimentation begin. Spirited and casual, Hudson is the perfect urban playground, where youthful curiosity hangs with eclectic enchantment, and around every corner lies another opportunity to explore.	1	866
ORIGINALS		
Originals are a family of individual hotels that shun the status quo, each distinctive and daring, creating a surreal fantasy where anything is possible. Stimulating, charismatic and iconic, Originals bring vision and style together with a spirit filled with magic and illusion.	4	725
Under Development	2	458
Total	13	4,212

Source: SBE - Morgans Hotel Group (2020) About Us [Online]. Available at: https://www.morganshotelgroup.com/page/about-us [Accessed 15 February 2020].

[13] SBE - Morgans Hotel Group (2020) About Us [Online]. Available at: https://www.morganshotelgroup.com/page/about-us [Accessed 15 February 2020].

After almost twenty years, Schrager stepped down from MOR in 2005, before the company's IPO in 2006 (Mashayekhi, 2016a). On 19 October 2005, MOR was incorporated as a Delaware[14] corporation to complete an IPO and its shares traded on the NASDAQ. On 17 February 2006, the company completed its IPO by offering 15,000,000 shares at $20 per share resulting in estimated net proceeds to the company of $272.3 million after 'underwriters' discounts'[15] and estimated offering expenses[16] (see Appendix 4). According to speculations, the company had been for sale since September 2007 and as a result, the following year it drew takeover interest from real estate investors and investment funds (MacIntosh, 2008). These events indicate a long-term interest from potential buyers because it was not until September 2016 that MOR's shareholders finally approved the group's acquisition by SBE Entertainment Group in a deal that valued the company at around $805 million and was completed in December 2016 (Gourarie, 2016; Karmin, 2016a).

Financial Performance 2006-2015

Similar to SHR and IHG, MOR did not escape the financial crisis; it performed poorly and this is the period when shareholder activists began acquiring stakes in the company. The group's revenues were in decline for almost a six-year period, down from approximately $306 million in 2007 to a low of approximately $189 million in 2012 (see Table 7.2).

[14] The state where the majority of the largest US companies are incorporated, and its corporate law often serves as the authority that other US states look to when developing their own statutory and case law (Rose and Sharfman, 2015).
[15] Is the differential between the price paid to the issuer for the new issue and the prices at which securities are initially offered to the investing public (USLEGAL, n.d.)
[16]SEC (2006b) Form 10-Q FOR THE QUARTER ENDED JUNE 30, 2006 [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000110465906054034/0001104659-06-054034-index.htm [Accessed 8 June 201e].

Table 7.2 MOR Revenue and Net Income Years 2006-2015

Year	Revenue ($)	Revenue Change %	Net Income ($)	Net Income Change %
2006	273,091,000		-10,228	
2007	306,249,000	12%	-11,975	17%
2008	300,679,000	-2%	-54,569	356%
2009	225,051,000	-25%	-101,605	86%
2010	236,370,000	5%	-83,648	-18%
2011	207,332,000	-12%	-88,442	6%
2012	189,919,000	-8%	-56,491	-36%
2013	236,486,000	25%	-44,150	-22%
2014	234,961,000	-1%	-50,043	13%
2015	219,982,000	-6%	22,050	-144%

Source: SEC (2010b) Form 10-K, Annual Report [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000095012311025968/c06644e10vk.htm#C06644106 [Accessed 16 May 2015]. SEC (2015g) Form 10-K, Annual Report [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000156459016014693/mhgc-10k_20151231.htm#ITEM3_LEGAL_PROCEEDINGS [Accessed 12 January 2016].

In September 2008, according to Smith Travel Research, hotel occupancy in the US was down 5% compared to the previous year. During the last week of September 2008, cancellations of reservations were running about 50% above normal at full-service hotels in the US (Sharkey, 2008). Weston (2009) argued that MOR did not perform well during the same period because of (1) its heavy exposure to the worst performing segment of the weak lodging industry and because (2) several properties in its portfolio were heavily mortgaged.

Because of the declining revenues over the six-year period (2007-2012), MOR's net income was negative with the biggest loss recorded in 2009 of $101,605. In the second quarter of 2009, Weston (2009) noted that MOR's revenue per available room had plummeted to -39.5% in contrast to the overall hotel industry that was around -20%. Even some of MOR competitors demonstrated negative results within the same period. For example, in the third quarter of 2008 profit fell 28% at Marriott International (Sharkey, 2008).

In 2013, MOR's revenues increased by 25% compared to 2012. Despite the revenue growth, over the next two years, MOR's revenues further declined by 6% reaching $219 million in 2015. During the same period, MOR presented positive income results in 2015 – this is the only time since 2006 that MOR net income results were positive – a year before its acquisition. MOR's financial performance also resulted in significant variations in its valuation which sunk to $52 million in 2016 after peaking at $800 million in 2007. In addition, in 2016 the company ended up in debt of $500 million (Mashayekhi, 2016a).

During the 2008-2013 period, MOR's stock performance was in the bottom 20% of companies in the NASDAQ composite index and its share price plummeted by 63%. After 2013 and up to the first quarter of 2015, the group's share price showed considerable stability at around $7 per share (see Figure 7.1) (Seeking Alpha (2017b).

Figure 7.1 MOR Share Price Years 2008-2016

Source: Seeking Alpha (2017b) MHGC [Online]. Available at: https://seekingalpha.com/symbol/MHGC [Accessed: 5 January 2018].

From March 2015 up to March 2016 MOR's share price showed a considerable drop and it reached $2.50 per share which is equal to a price drop of 79% (Seeking Alpha, 2017b). In addition, had the company performed in line with its peers, its equity market capitalisation would be nearly four times what it was in 2013 (almost $272.9 million) (Business Wire, 2013d).

After several efforts and intensifying pressure from all shareholder activists, in December 2016, SBE acquired the group. Shortly before the acquisition was approved, MOR's market capitalisation was $47.97 million as of 31 March 2016 (Equities Staff, 2016), a considerably reduced figure compared to 2008 and before the peak of the financial crisis, when its market capitalisation had been estimated to be $415 million (MacIntosh, 2008). The interesting part of MOR's takeover is the fact that SBE's owner, Sam Nazarian has a 50% interest in SBE including the day-to-day management responsibilities, with the remainder of the group split between YC (former

MOR shareholder) and real estate investment firm Cain Hoy Enterprises (Doggrell, 2017).

Leadership

Some of the problems that the company faced, according to analysts started when the company went public in 2006. Ryan Meliker, a hotel analyst, told the Wall Street Journal in 2013 that: '*Morgans should not be a public company*. *It is way too small a company to be public and have public operating and reporting costs*' (Mashayekhi, 2016a). After Schrager's departure in 2005, four chief executive officers led MOR and since 2013, the company had been without a permanent CEO and its interim CEO left the company in 2015 (Ting, 2016). The continuous leadership changes exposed problems in the company's corporate governance structure, a point emphasised by all activists during their tenure. Prior to its acquisition, MOR's executive officers were Richard T. Szymanski, Meredith L. Deutch and Chadi Farhat (see Table 7.3).

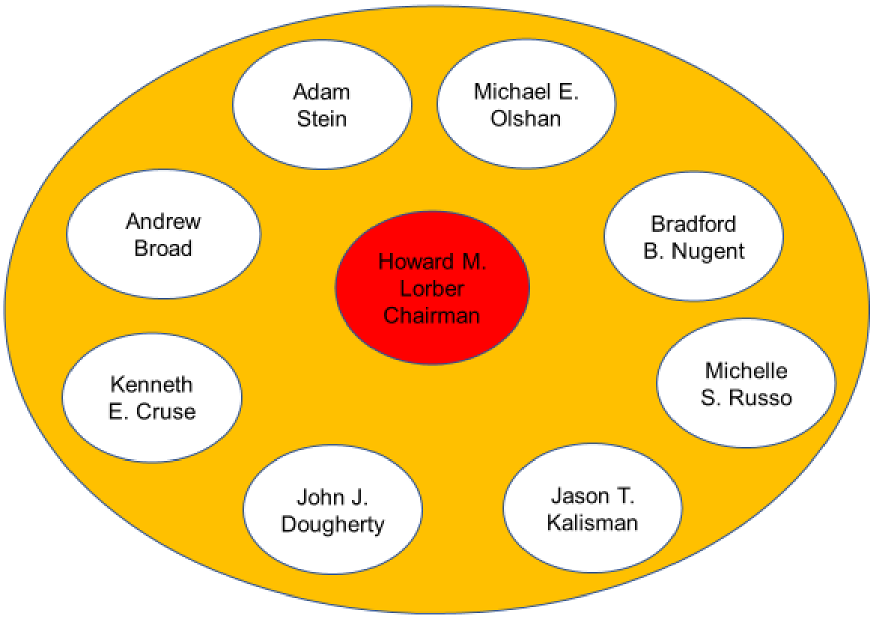
Table 7.3 MOR Executive Officers Before its Acquisition as of December 2016

Name	Role	Other MHG roles
Richard T. Szymanski	Principal Executive Officer for SEC Reporting Purposes since May 2016	Chief Financial Officer
Meredith L. Deutsch	Executive Vice President, General Counsel (since May 2014)	Secretary (since March 2015)
Chadi Farhat	Senior Vice President and Chief Revenue Officer of the Company (since March 2015),	Interim Chief Operating Officer since February 2016

Source: SEC (2016b) Schedule 14A - Proxy Statement [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000156459016016282/mhgc-def14a_20160512.htm [Accessed 16 December 2016].

MOR's officers who were part of its operating structure were not members of its Board (see Figure 7.2). Therefore, their non-presence on the Board would restrict their views on several matters concerning the company, especially MOR's potential sale. MOR's longest serving officer, Richard Szymanski (CFO since 2005) was appointed as its principal executive officer for SEC reporting purposes in 2016, a role that could be linked to speculations over a sale of the company.

Figure 7.2 MOR Board of Directors as of 18 May 2016



Source: SEC (2016c) Form 8-K - Submission of Matters to a Vote of Security Holders [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312516594440/d194270d8k.htm [Accessed: 16 December 2017].

MOR's Board consisted of nine members. The Board's chairman was Howard Lorber whose company (Vector Group) had shareholder interests in MOR and held the role because the company did not have a CEO at the time. MOR did not have a policy regarding whether the offices of Chairman of the Board and Chief Executive Officer could or could not be held by the same individual. MOR's governance documents permitted the Chairman and Chief Executive Officer to be the same or different individuals. This provided the Board with the flexibility to determine whether these roles should be combined or separated based on the company's circumstances and needs at any given time (SEC, 2016c). As can be seen below (see Table 7.4), six Board members had a shareholder interest in the company. Four Board members with shareholder interest pursued an activist approach during their tenure at the company, while two of MOR's shareholder activists did not have Board representation at the company's Board before its acquisition (KCM and RH).

Table 7.4 Overview of the Members of the Board of Directors

Name	Board of Directors Member Since…	Role at the Board	Other Duties at the Board	Professional Role	Interest in MHG
Howard M. Lorber	(March 2015)	Chairman of the Board (since May 2015)	Corporate Governance and Nominating Committee since May 2015 - Operating Committee of the Board	President and CEO Vector Group	Vector Group (Shareholder)
Andrew Board	(May 2014)	Board Member	-	Vice President and Partner at Hotel Assets Group, LLC (Has been the principal broker for over 150 hotel transactions throughout the United States)	-
Kenneth E. Cruse	(March 2015)	Board Member	Audit Committee since May 2015 - Operating Committee of the Board	CEO Alpha Wave Investors LLC	-
John J. Dougherty	(June 2013)	Board Member	Chairman of the Audit Committee, member of the Compensation Committee and the Corporate Governance and Nominating Committee	Up to June 2013 - Vice President of Olshan Hotel Management Inc	**The Olshan family is one of the owners of OTK Associates, LLC (Shareholder Activist)**
Jason T. Kalisman	(April 2011)	Board Member (was the interim CEO at MOR and was Chairman of the Board of Directors)	Member of the Corporate Governance and Nominating Committee from July 2011 through March 2013 and from June 2013 through August 2013	CEO Talisman Group, LLC	**Founding member of OTK Associates, LLC (Shareholder Activist)**
Bradford B. Nugent	(April 2015)	Board Member	-	Partner at Yucaipa Companies	**Yucaipa Companies (Shareholder Activist)**
Michael E. Olshan	(June 2013 - May 2014) (November 2015)	Board Member	Chairman of Corporate Governance and Nominating Committee from June 2013 to May 2014. Corporate Governance and Nominating Committee, Operating Committee of the Board of Directors	Chairman and Managing Partner of O-CAP Management, L.P. Co - Manager of OTK Associates LLC	**Co-manager of OTK Associates, LLC (Shareholder Activist)**
Michelle S. Russo	(May 2014)	Board Member	Chairman of the Compensation Committee	Chief Executive Officer of Hotel Asset Value Enhancement	-
Adam Stein	(November 2015)	Board Member	Member of our Compensation Committee and Audit Committee	Portfolio Manager at Pine River Capital Management	Pine River Capital Management (Shareholder)

Source: SEC (2016c) Form 8-K - Submission of Matters to a Vote of Security Holders [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312516594440/d194270d8k.htm [Accessed 16 December 2017].

In contrast, the shareholder activists who had Board membership had been on the company's Board for a few years. Jason T. Kalisman had been a Board member since April 2011 and he had served as an interim CEO and as the Chairman of the Board. Three members of MOR's Board were part of OTK, while one member represented YC. During shareholder activism both funds had different visions about MOR's future.

7.2 The Activists

OTK Associates (OTK) LLC

OTK was a Delaware limited liability company based in Michigan and it was an investment entity (SEC, 2008B).[17] The entity was controlled by the Olshan hedge-fund family (50%) and the Taubman luxury-mall family (50%) (Hudson, 2013c). The Olshan family privately owns a real estate firm. Olshan properties specialises in the development, acquisition and management of commercial real estate. The company manages properties in 11 US states with a staff of over 1,000 employees (Olshan Properties, 2017). The Taubman family controls Taubman Centers, a real investment trust (REIT) that owns, manages and/or leases 26 regional, super-regional and outlet shopping centres in the US and Asia (Taubman, 2020).

On 22 January 2008, OTK bought 4,500,000 shares representing almost 14% of MOR's outstanding common shares of approximate value of $68.4 million. OTK filed a Schedule-13D report on 27 February 2008 to report the purchase of shares in the open market for investment purposes (SEC, 2008B). According to PR Newswire

[17] SEC (2008b) Form SC 13D [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000095012408001036/k24545sc13d.htm [Accessed 7 March 2015).

(2015c), OTK was not an investment advisor, investment fund or other professional enterprise, it did not have any online presence and after extensive research on the Internet, the study did not identify other investment holdings of the firm. Although OTK claimed that they were not ‘a shareholder activist’, throughout their investment in MOR they pursued an activist approach with numerous interventions into the workings of MOR’s Board.

Yucaipa Companies (YC) LLC

YC is an investment company founded in 1986 by Roland Burkle, one of the US’s preeminent investors in several industries. The company has completed mergers and acquisitions valued at more than $40 billion. According to its website, the firm ‘*works with management to strategically reposition businesses and implement operational improvements, resulting in value creation for investors*’ (The Yucaipa Companies, 2020).

YC specialises in start-ups, middle market, growth capital, industry consolidation, buyouts and turnaround investments and usually invests in food-related businesses, distribution, consumer, retail, logistics, hospitality and entertainment industries. It considers investments between $25 million and $300 million and will invest in companies with revenues of between $300 million and $500 million (Bloomberg, 2017b). Table 7.5 set outs some of YC’s and Burkle’s most notable investments over the 10-year period, 2006-2016.

Table 7.5 YC and Burkle's Investment Portfolio 2006-2015

Company	Industry	Number of Shares	% of share hold	Value ($)	Filing Date
WILLAMETTE INDUSTRIES, INC.	Forest Products	5,102,200	91.25	290,366,202	10th August 2006
WHOLE FOODS MARKET INC.	Consumer Products	9,810,000	7	98,900,000	8th January 2009
MORGANS HOTEL GROUP	Hospitality	12,522,367	26.4	26,923,095	9th May 2016
AMERICAN APPAREL INC COM	Retail	4,300,000	6	5,900,000	25th June 2010
SIMON WORLDWIDE INC.	Marketing / Advertising	65,287,045	87.6	652,870.450	22th December 2015

Source: WhaleWisdom (2017a) Burkle Roland [Online]. Available at: https://whalewisdom.com/filer/burkle-ronald- w#tabsummary_tab_link [Accessed 10 November 2017].

YC's investment portfolio confirms its strategy to invest in small to medium companies. YC's total shareholding interests in companies ranged from 6% to 91.25% from 2006-2016 (WhaleWisdom,2017a). This may be related to the nature of the fund's investments; for example, it may be linked to their intentions in terms of whether they would pursue a sale or merger of the target or push for changes in the governance structure of each target. YC has since exited all the above investments.

Consumers' decisions to shift down market from luxury hotel brands after the financial crisis caused problems for hotel operators. Worried about liquidity and searching for expansion, MOR made a deal with YC. Through two affiliated investment funds at multiple levels of MOR's capital structure, YC exercised significant influence over the company (Delaware Courts, 2013). On 15 October 2009, YC made a $75 million infusion[18] to MOR and in exchange the fund received preferred securities that had an

[18] A private investment in private equity, or PIPE. In other words, Yucaipa had taken a large ownership (lending money), rescuing the company (MHG).

8% dividend rate for the first five years, a 10% rate for years 6-7; and for any remaining balances a 20% rate thereafter. In addition, YC received warrants to acquire as many as 12.5 million shares (at an exercice price of $6 per share) of MOR's common stock at the time, the right to nominate one director and extensive control rights (veto sale) over MOR (SEC, 2009b; Solomon, 2013b).[19]

As of May 2013, YC owned almost 28% of MOR, had bought $88m of its debt and one of its directors was in charge of MOR (Gray, 2013a). Solomon (2013b) believed that it was unclear whether MOR's management appreciated the consequences of handling this degree of control over the company to YC. However, in an investment conference call in 2009, MOR's president referred to YC and Burkle's investment as being 'shareholder friendly' and able to provide the company with the flexibility to manage the post financial crisis period (Solomon, 2013b).

Kerrisdale Capital Management (KCM)

KCM is a private investment management company based in New York, focusing on value investments (Kerrisdale Capital, 2020a). The hedge fund was founded in 2009 by Sahm Adrangi and currently manages approximately $500 million on investments (Kerrisdale Capital, 2020b). The fund had recorded strong gains since 2009 by betting both for and against company stocks and in the year period 2009-2014, it averaged an annual return of approximately 28%. However, at the beginning of 2016, like other hedge funds, the firm suffered double-digit drops resulting in a 7% loss in the first

[19] SEC (2009b) Form SC 13D [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1015899/000110465909067170/a09-32210_1sc13d.htm [Accessed 10 June 2015].

quarter of the year (Herbst-Bayliss, 2016). The firm’s total investment portfolio was worth approximately $500 million in April 2016 (Delevingne, 2016); however, the firm’s SEC filing in June 2017 disclosed a portfolio worth approximately $108 million (see Table 7.6).

Table 7.6 KCM Portfolio as of 14th August 2017

Company	Industry	Number of Shares	% of share hold	Value ($)	Filing Date
LUXOFT HLDG INC	Technology	306,481	17.16	18,649,000	30th June 2017
GIGAMON INC	Technology	462,989	16.77	18,219,000	30th June 2017
COGNIZANT TECHNOLOGY SOLUTIO	Technology	129,396	7.91	8,592,000	30th June 2017
EBAY INC	E-Commerce	227,555	7.31	7,946,000	30th June 2017
CARS COM INC	Consumer Discretionary	265,000	6.49	7,057,000	30th June 2017
FOOT LOCKER INC	Consumer Discretionary	130,800	5.93	6,446,000	30th June 2017
STAMPS.COM INC	Consumer Discretionary	39,781	5.67	6,161,000	30th June 2017
YELP INC	Industrials	200,000	5.52	6,004,000	30th June 2017
NUTANIX INC	Technology	272,550	5.05	5,492,000	30th June 2017
TOTAL SYS SVCS INC	Technology/Financial	93,919	5.03	5,471,000	30th June 2017
JONES LANG LASALLE INC	Real Estate	40,433	4.65	5,054,000	30th June 2017
PURE STORAGE	Technology	363,464	4.28	4,656,000	30th June 2017
PALO ALTO NETWORKS INC	Technology	23,000	2.83	3,078,000.00	30th June 2017
CHECK POINT SOFTWARE TECH LT	Technology	13,993	1.34	1,461,000	30th June 2017
ZENDESK INC	Technology	38,900	0.99	1,081,000	30th June 2017
ETSY INC	Consumer Discretionary	70,000	0.97	1,050,000	30th June 2017
AZUL	Aviation	37,968	0.74	800,000	30th June 2017
CARA THERAPEUTICS INC	Health Care	50,000	0.71	770,000	30th June 2017
FIESTA RESTAURANT GROUP INC	Consumer Discretionary	33,168	0.63	685,000	30th June 2017

Source: WhaleWisdom (2017b) Individual Manager Holdings [Online]. Available at: http://legacy.whalewisdom.com/filer/kerrisdale-advisers-llc#/tabholdings_tab_link [Accessed 15 August 2017].

KCM's investments ranged from approximately $18.65 million to approximately $685K and they represented shareholder interests that ranged from 0.63% to 17.16%. On 14

February 2013, KCM acquired for the first time, 243,491 of MOR's shares with a value of approximately $1,35 million (SEC, 2013c).[20] The hedge fund continued to gradually acquire MOR shares and after a year (on 14 February 2014), its investment resulted in the possession of 1,272,965 shares (an almost 4% stake in the company at the time) with a total value of approximately $10.35 million (SEC, 2014C).[21] KCM was a strong supporter of MOR's sale and intensified the pressure during their activism through several interventions.

Rambleside Holdings LLC (RH)

RH is a family-controlled investment company that is active across the real estate spectrum and includes direct investing, development and lending (PR Newswire, 2017). The company is a subsidiary of Rambleside Real Estate Capital LLC and its founder, Gregory Cohen, is a well-known activist investor. Commenting on his activist approach he has argued that 'w*e're just not afraid or intimidated to go after companies that are acting in an inappropriate way*' (Morrissey, 2016). RH's intervention in MOR was short as it took place approximately between August 2015 and February 2016. During the seven-month period the company held almost 4% of MOR's shares (Hospitality Net, 2015). Other notable RH investments included the New York REIT and the Ashford Hospitality Trust (Morrissey, 2016).

[20] SEC (2013c) Form 13F-HR [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1569688/000156968813000002/0001569688-13-000002-index.htm [Accessed 10 June 2015].

[21] SEC (2014c) Form SC 13F-HR [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1569688/000108514614000658/0001085146-14-000658-index.htm [Accessed 10 June 2015].

During their activism at MOR, RH offered to buy two of the company's hotels, a move that would have complicated the merger talks between MOR and SBE Entertainment Group. In a letter sent to MOR's Board, RH stated that it would pay $507 million in cash to acquire the Hudson Hotel in New York and the Delano Hotel in Miami (Karmin and Hoffman, 2015). The same year, RH took part in another intervention with one of its holdings. The company criticised the New York REIT over its share price and management decisions. Throughout its activism, RH managed to convince the REIT's management to sell four properties (Morrissey, 2016).

7.3 Case Overview

Prior to presenting the case, it is important to note the period at which each shareholder activist acquired and sold the company's shares (see Table 7.7). The case is presented in chronological order to illustrate the intervention of each activist in the workings of MOR's Board.

Table 7.7 Shareholder Activists' Investment Overview

Shareholder Activist	Shares in MHG bought in the month and year	% of common stock in MHG (approx.)	Shares in MHG sold	Activism in years/months
OTK Associates	January 2008	14	End of September 2016	8.8
Yucaipa Companies	November 2009	28	MHG has been acquired by SBE where YC are shareholders	6.8
Kerrisdale Capital Management	February 2013	4	End of September 2016	3.7
Rambleside Holdings	Before August 2015	4	End of September 2016	1.1

Although the activities of all activists ended in December 2016, their initial investments began at different periods and their tenure in the company varied. OTK and YC acquired MOR’s shares in 2008 and 2009 respectively and remained shareholders for eight and seven years respectively. On the other hand, KCM and RH acquired MOR’s shares in 2013 and 2015 respectively and their investments lasted for three and one years. Although the acquisition of MOR’s shares by shareholder activists began in 2008, the interventions and the pressure exerted by the activists did not start until 2012.

7.4 Shareholder Activism Events

This section presents how the events unfold during the period 2009-2016. Prior to presenting the events, this case study presents an overview of key events that occurred to MOR during the activism period (see Table 7.8) in order to enable a thorough view of the case.

Table 7.8 Overview of Key Events During the Shareholder Activism Period

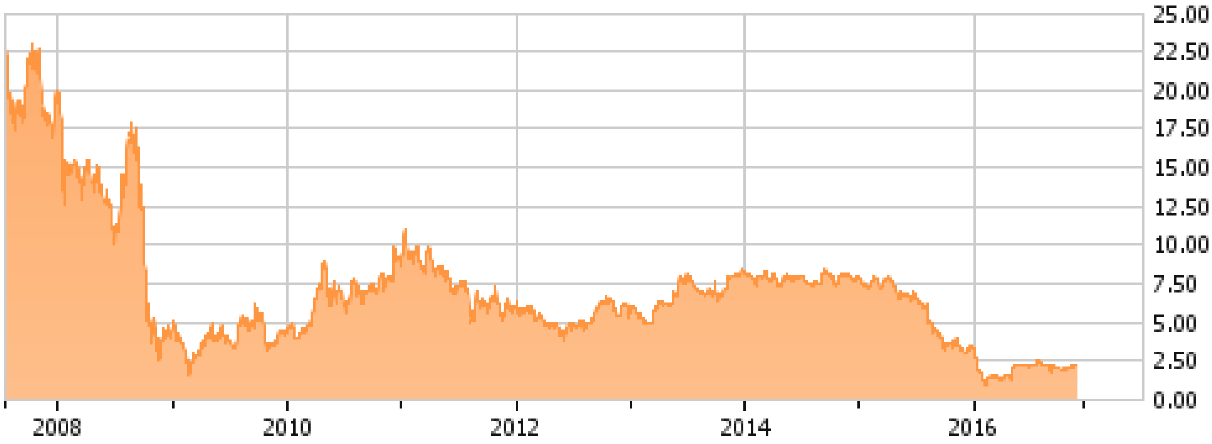
Dates	Event
2008	
22nd January	OTK bought for the first time 4,500,000 (14 per cent of MOR's shares).
2009	
16th November	YC made a $75 million infusion to MOR.
2011	
Throughout the year	MOR sold five of its properties
December	MOR's Board of Directors established a Special Committee to evaluate potential strategic alternatives for the company.
2012	
October and November	On two several occasions, Hyatt Hotels Corporation sent a letter to MOR expressing their interest in acquiring all outstanding shares, a proposal that was immediately declined and not discussed.
2013	
14th February	KCM acquired 243,491 shares (4 per cent of MOR's shares).
15th March	OTK sent a letter to MOR indicating their intention to nominate seven nominees to the Board of Directors.
18th March	OTK sent a letter to MOR shareholders indicating the reasons for its proposal to alter its Board of Directors.
29th March	On 29 March, OTK was notified by MOR's counsel that a meeting would take place the following day to review and approve a recapitalisation.
1st April	MOR duly announced the recapitalisation.
2nd April	OTK issued a press release expressing their concern about MOR's recapitalisation announcement.
5th April	OTK filed a motion to join a derivative lawsuit filed in Delaware Court to stop the transaction between MOR and YC. Few days later the court granted OTK's motion.
15th April	OTK released another press release where continued to ask the Delaware Chancery Court to invalidate and rectify the YC transactions.
14th May	The Delaware Court of Chancery granted a preliminary injunction prohibiting MOR's board from taking any steps to postpone the annual shareholders meeting or to change the record date for the annual shareholders meeting.
28th May	OTK delivered a presentation to investors and ISS addressing a number of areas that has raised concerns over the years.
30th May	MOR made a presentation to ISS and to investors
31st May	OTK issued a letter to shareholders asking them for their support to elect its seven nominees at the company's upcoming annual meeting of shareholders.
5th June	ISS had rejected OTK's attempt to take control of the MOR Board.
14th June	MOR shareholders elected OTK's entire panel of nominees.
20th June	KCM sent a letter to the Board of Directors urging the company to move forward with a thorough and careful coordinated sale process.
1st July	Burkle filed a complaint against OTK for using false and misleading proxy materials to take control of the Board of Directors.
30th August	MOR announced the departure of its CEO, Michael Gross and appointment of Kalisman as CEO on an interim basis.
5th September	KCM sent a letter to shareholders indicating its intention to nominate a separate set of directors to the Board at the 2014 Annual Meeting.
Beginning of September	Burkle demanded that MOR find a buyer following the departure of the CEO.

31st October	YC sent another letter to the Board of Directors expressing a desire to make a proposal to the board to purchase the company for $8.00 per share. Sources told that Kalisman and MOR had rejected YC's offer.
2014	
Beginning of the year	MOR borrowed $450 million against two of its properties.
28th February	MOR, OTK as well as a number of other associates entered into a binding Memorandum of Understanding with YC and Burkle.
12th March	KCM delivered a letter to MOR and to the company's shareholders announcing their intention to nominate seven individuals for election to the Board at the 2014 Annual Meeting of Shareholders.
2nd April	KCM sent a letter to the Board highlighting the qualifications of its director nominees.
22nd April	MOR presented the actions and improvements of the Board over their tenure prior to the 2014 annual meeting of shareholders.
7th May	YC sent a letter to the Interim CEO of MOR outlining repeated failures by the company to honour certain investor observation rights.
9th October	MOR was looking to sell one of its properties.
2015	
August	RH acquired 4 per cent stake in MOR.
6th August	Sources revealed that SBE was close to an agreement to merge with MOR.
14th September	RH offered to buy two hotels owned for $507 million in cash.
31st October	The possibility of the merger broke down.
2016	
February	MOR's share hit a low of $0.79 per share.
February	RH sent a letter to MOR expressing serious concerns about the strategic direction of the company.
9th May	MOR entered into an agreement and plan of Merger with SBEEG Holdings, LLC. The takeover was challenged by (Rigrodsky & Long) exploring "potential legal claims" against MOR's Board of Directors.
28th September	MOR shareholders voted to approve SBE's acquisition of MOR.
30th November	SBE acquired MOR for $2.25 per share, or $805 million.

7.4.1 Period I: January 2009-December 2012

Following the financial crisis, MOR's share price dropped significantly compared to the close of its first year of trading, when it stood at $20 per share (see Figure 7.4). From a peak of approximately $22.50 per share in the second half of 2007, MOR's share price started to decline and by 2009, it had sunk to almost $2.50 per share. Its share price started to recover in 2010, rising to $5 per share, albeit with continuous fluctuations. It reached a peak of approximately $10 per share, however, it ended again at almost $2.50 per share in the second half of 2016.

Figure 7.3 MOR Share Price 2008-2016



Source: Seeking Alpha (2017b) MHGC [Online]. Available at: https://seekingalpha.com/symbol/MHGC [Accessed 5 November 2017].

MOR's share price performance demonstrates both similarities and differences compared to two competitors, Wyndham Worldwide Corporation (currently Wyndham Destinations) and Marriott International. WYN's share price followed a similar path to MOR's share performance when in February 2009, it sunk to $1.66 per share. However, its share price started to recover and gradually increased from the second half of 2009 to the current date, with several fluctuations after the second half of 2015 (Seeking Alpha, 2020a). Marriott's share price followed a similar path (albeit in higher $ share value). In February 2009, its share reached $14.15 per share, but its share price started to recover and gradually increased from the second half of 2009 to date with minor fluctuations after the second half of 2015 (Seeking Alpha, 2020b).

On 16 November 2009, YC filed a Schedule 13D where, in exchange for a $75 million infusion, it would receive preferred securities and warrants to acquire as many as 12.5 million shares or 9.9% of MOR's shares ($3.61 share price value), the right to nominate one director and extensive control rights (veto sale) over MOR (SEC, 2009b).[22] OTK as a shareholder in the company since January 2008, also voted favourably for this transaction.

A few years later, in 2011, MOR operated under challenging conditions as it struggled with a long-term mortgage debt of $534.9 million, equal to about 2.5 times its market capitalisation. The high amount of debt and the decline in the share price made the company a potential acquisition target (Chernikoff, 2011; Reuters, 2011). On December 2011, following the challenges that MOR was facing, its Board established a Special Committee to evaluate potential strategic alternatives for the company, including a possible transaction with YC (Hotel-Online, 2013). One of the committee members was Kalisman, OTK's Director. In its 2011 annual report, MOR referred to its corporate strategy of growing by (1) leveraging its management experience, (2) expanding its hotel portfolio into new and existing markets, and (3) targeting internal

[22] SEC (2009b) Form SC 13D [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1015899/000110465909067170/a09-32210_1sc13d.htm [Accessed 10 June 2015].

growth opportunities. To execute this strategy, MOR aimed to shift towards a 'light asset model', which would be achieved by selling five hotels while retaining the management pursuant to long-term management agreements (SEC, 2012).[23] Within the same year, the group sold two of its London properties – the Sanderson Hotel and St Martins Lane – for approximately $300 million while retaining the management of both properties (Stamford, 2011).

During 2012, MOR was under continuous pressure from YC who made proposals to acquire some of its assets in exchange for YC's various holdings in the company. YC's proposals were stopped by Kalisman who influenced the Special Committee to stop YC's plans for further control of MOR (Delaware Courts, 2013). Towards the end of the year, in October, Hyatt Hotels Corporation (HYC) sent a letter to MOR expressing their interest in acquiring all MOR's outstanding shares '*at a meaningful premium to recent trading levels*', a proposal that was declined (Delaware Courts, 2013).

The following month (November), HYC offered to purchase all outstanding shares of MOR for $7.50 per share price, subject to due diligence. The Special Committee decided that MOR should not engage in discussions with HYC. YC objected to any public disclosure of the HYC bid and threatened to not proceed with the rights offering if the offer was disclosed. MOR's counsel advised that HYC's offer was important information and should be disclosed. However, the Special Committee went against the counsel's advice by giving in to YC and subsequently, failing to provide any disclosure about the HYC bid. Although the Special Committee developed a range of

[23] SEC (2012) Form 10-K [Online]. Annual Report 2011. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312512106816/d288074d10k.htm [Accessed 10 June 2015].

options for MOR, the process of exploring strategic alternatives stalled a month later, in November (Delaware Courts, 2013).

7.4.2 Period II: January 2013-December 2013

On 15 March, OTK sent a letter to MOR indicating their intention to nominate seven nominees to the Board at the Annual Meeting of the Shareholders, on 15 May (SEC, 2013E).[24] OTK suggested nominating six candidates and Kalisman, whom OTK supported for re-election (AllAboutAlpha, 2013a). OTK's intention was to replace seven of MOR's eight-member Board (Hoffman, 2013a). Three days later, on 18 March, OTK sent a letter to MOR shareholders indicating the reasons for its proposal to alter its Board. OTK's arguments focused on issues such as the waste of resources and failure to capitalise on MOR's brand value by the Board and the company's poor management. They argued that this had resulted in poor financial performance for MOR in the period 2008-2012 when the company made almost $450 million in annual losses, and questionable leadership decisions during the Board's tenure (SEC, 2013F).[25]

The latter included the appointment of a CEO, Michael Gross, who had never previously served in a publicly listed company and was a paid employee (from 2008-2011) for MOR's largest holder (YC) of convertible securities and preferred shares. OTK believed that their proposal for its panel had been developed to refocus MOR on

[24] SEC (2013d) Form SC 13D [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513111249/d503682dsc13da.htm [Accessed 10 June 2015].

[25] SEC (2013e) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513111256/d503784ddfan14a.htm [Accessed: 10 June 2015].

its core business, increase its portfolio and reduce operating cost structure (SEC, 2013F).

OTK also criticised MOR for cancelled management contracts, property foreclosures, debt restructurings, and '*generous'* compensation for executives. OTK said at the time that if it could not return the company to profitability, it would '*appropriately evaluate and pursue strategic alternatives in a disinterested fashion*' (Hoffman, 2013a). However, MOR's CEO, Michael Gross, argued that '*OTK entered the company stock at an average cost of about $15.20 per share, raising questions about whether it would support a sale of the company below this price*' (Koyitty, 2013).

Gross's statement shows that OTK would not explore and pursue strategic alternatives unless MOR's share price showed signs of improvement. In March, MOR's share price was trading below $7 per share and it would potentially represent a loss for OTK if the company explored strategic alternatives. On the same day that OTK sent the letter to shareholders, MOR stated that it would review the letter and respond appropriately. The Board considered the fact that OTK already held Board membership proportionate to its ownership and proposed to take full control of the company's Board without paying a premium to MOR's remaining shareholders (SEC, 2013G).[26]

On 29 March, OTK was notified by MOR's counsel that a meeting would take place the following day to review and approve a recapitalisation. This recapitalisation

[26] SEC (2013f) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513113378/d505197ddefa14a.htm [Accessed 12 June 2015].

involved wanting to shift their business plan to focus on managing hotels, rather than owning them, a strategy suggested by YC. Under the terms of the transaction, MOR would transfer one of its signature assets, the Delano Hotel in Miami Beach, and one of its subsidiaries, The Light Group, to entities affiliated with YC (Delaware Courts, 2013). In exchange, the latter would transfer to the company 75,000 shares of its Series A preferred stock, warrants to purchase 12.5 million shares of its common stock, and $88 million of its notes. In addition, YC would backstop a $100 million rights offering. If any shares were not purchased in the rights offering, YC would have the right to purchase those shares. Eventually, on 1 April 2013, MOR duly announced the recapitalisation (Voien, 2013).

On 2 April, OTK issued a press release expressing their concern about MOR's recapitalisation announcement and its seemingly close engagement with YC. OTK questioned whether the Board's Special Committee had considered the fact that the two MOR directors involved had a significant financial interest in the transaction. In addition, OTK believed that the recapitalisation would place a large block of stock in 'friendly' hands prior to the company's annual meeting. On 5 April, OTK subsequently filed a motion to join a derivative lawsuit filed in Delaware Court to stop the transaction between MOR and YC (SEC, 2013H).[27]

On 9 April, MOR issued a press release announcing that it had '*voluntarily rescheduled the $100 million pro-rata rights offering*' and that it would close after the recorded date

[27] SEC (2013g) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513137605/d515052ddfan14a.htm [Accessed 12 June 2015].

of the company's 2013 Annual Meeting (SEC, 2013I).[28] On 15 April, OTK intensified its pressure by releasing another press release in which they continued to ask the Delaware Chancery Court to invalidate and rectify the YC transactions. OTK required from the Board that: i) YC waive its termination fee, ii) the YC transactions be terminated and iii) it should proceed with the original meeting date and record date.

OTK stated that if elected, they would refocus the company on its core business, extend its brand portfolio and improve its operating cost structure. On 1 May, MOR held a conference call discussing its first quarter 2013 results and its CEO, Michael Gross, stated that the negotiations with YC had been ongoing for one and a half years and that OTK had been part of the process (SEC, 2013J).[29]

On 28 May, OTK delivered a presentation to investors and ISS[30] addressing areas of concern, namely, MOR's share price performance and the Board's composition that had been raised over the years (SEC, 2013K).[31] Some of these areas included:

1. <u>Share price performance</u>. Since its IPO, MOR had underperformed compared with competitors such as Choice Hotels International, Marriott International and Wyndham

[28]SEC (2013h) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513147302/d519162ddefa14a.htm [Accessed 12 June 2015].

[29]SEC (2013i) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513154991/d521764ddfan14a.htm [Accessed 12 June 2015].

[30] The world's leading provider of corporate governance and responsible investment solutions for asset owners, asset managers, hedge funds and asset service providers.

[31]SEC (2013j) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513236552/d539255ddfan14a.htm [Accessed 10 June 2015].

Hotels and Resorts and peer groups such as Wynn Resorts, Ryman Hospitality Properties from 2009-2013.

2. Poor returns. Since its IPO its returns were significantly below peers over the period 2009-2013.

3. Qualifications of MOR Board of Directors (see Table 7.9).

Table 7.9 Lack of Qualifications of MOR Board of Directors

Existing Directors are not Qualified to Serve on the Morgan's Board	
Name	**Key Attributes**
Michael Gross	No previous lodging experience
	No previous operating experience
	Partnered with Yucaipa since 2004 and handpicked by Yucaipa to be CEO; lack of independence
Jeffery Gault	No previous lodging experience
	President and CEO of Americold, a Yucaipa portfolio company; lack of independence
Thomas Harrison	No previous lodging experience
	No real estate experience
	Marketing services background
Robert Friedman	No previous lodging experience
	No real estate experience
	Entertainment background
Ron Burkle	No previous lodging experience
	No real estate experience
	Founding and Managing Director of Yucaipa; inherent conflict of interest with shareholders

Source: SEC (2013j) Form SC 14A Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513236552/d539255ddfan14a.htm [Accessed: 16 June 2017].

MOR's Board poorly executed its asset-light strategy, resulting in declining revenues, declining EBITDA margins and negative net income. The company's largest general and administrative item was executive compensation that was not related to MOR's performance. Re-electing the Board at the time would be destructive for MOR as their interests were not aligned with those of the shareholders. In response to OTK's presentation, on 30 May, MOR made a presentation to ISS and to investors (SEC, 2013L)[32] committing that it intended to increase value by establishing and executing a clear strategy by creating shareholder value (see Table 7.10).

Table 7.10 MOR's Economic Model

Creating Shareholder Value - Our Detailed Economic Model	MORGANS HOTEL GROUP
Target Signing of 2-4 New Contracts Per Year	**Shareholder Value**
4 new contracts signed in 2012	
Current infrastructure capable of supporting additional business	
Long-Term Contracts: 15-20 Years Plus Renewals	
Base fees and chains service reimbursements on managed hotels	
Incentive fees	
License fees on selected hotels	
Limited Capital Investment	
Historical fees per hotel management agreement average between $750,000 to $1 million per 100 rooms	
Target a 3-4 year payback on upfront invested capital	
High Incremental Margins	
Incremental cash flow margins projected at 90% on new hotels in the pipeline due to scalable infrastructure	

Source: SEC (2013j) Form SC 14A Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513236552/d539255ddfan14a.htm [Accessed: 16 June 2017].

MOR also stated that OTK's director nominees were not aligned with shareholder interests. It criticised the activist for: 1) lacking a credible alternative to create shareholder value, 2) not having a credible record of controlling Boards and 3)

[32]SEC (2013k) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513240302/d546743ddefa14a.htm [Accessed: 10 June 20

suggested nominees lacking relevant experience. Both families that controlled OTK had family members who were director nominees on behalf of the company.

Following MOR's presentation, OTK issued a letter to shareholders asking them for their support to elect its seven nominees at the company's upcoming annual meeting of shareholders (SEC, 2013M).[33] In response to OTK's letter to shareholders, MOR issued a press release on 4 June 2013 stating its Board was committed to initiating a process to explore strategic alternatives, including the company's sale, upon their re-election at the following annual meeting. At the same time, a representative of YC announced that it would support MOR's panel in pursuing such a process, as YC did not believe that OTK was qualified to run such a process and believed that their election to the Board would '*lead to continued uncertainty and animosity and deter any effort to maximise shareholder value*' (SEC, 2013N).[34] In addition, YC's representative commented that YU would not be a bidder for the company (SEC, 2013N).

On 4 June, MOR announced that it had received five expressions of interest in a takeover and was considering a sale. The news sent MOR's share to its highest price ($7.53) in almost two years (Gray, 2013b). On 5 June, according to a press release by MOR, it was announced that ISS had rejected OTK's attempt to take control of MOR's Board, having identified 'significant deficiencies' with the seven candidates offered by OTK that made them '*incapable of representing the interests of all shareholders'*. MOR had previously announced that it would nominate six candidates

[33]SEC (2013l) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513243508/d539255ddfan14a.htm [Accessed 10 June 2015].

[34]SEC (2013m) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513251017/d551158ddefa14a.htm [Accessed: 10 June 2015].

for its seven-person board, thereby ensuring that OTK would be represented on the Board by at least one director, representation proportional to OTK's share ownership (Gray, 2013b; SEC, 2013O[35]).

On 14 June, at the company's annual meeting, MOR shareholders duly elected OTK's entire panel (seven nominees) who opposed the YC transaction. The results came as a surprise, disappointing some investors and pushing the group's shares down by 8%. Several observers commented that shareholder support for MOR's incumbent Board was increasing following its promise to sell the company if re-elected (Koyitty, 2013). On 20 June, YC sent a letter to the new Board, demanding to know whether it intended to go through with the Delano disposal. Up to the date that YC sent the letter, they did not receive a response, which equated to a breach of the agreement. YC demanded a termination fee of $9 million, and another $1 million of related costs. However, analysts at the time had a contrasting view regarding the YC filing, believing that The Delano was no longer in financial straits and the disputed deal was a proxy for a larger fight over control of the company (AllAboutAlpha, 2013b).

On 19 June, KCM also sent a letter to the Board urging the company to move forward with a thorough sale process, to be led by a reputable investment banking firm (Kerrisdale Capital, 2013). KCM believed that MOR would be an attractive asset for a large international hotel company and they would put forward a panel of bankers, hotel

[35]SEC (2013n) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513247864/d548027ddefa14a.htm [Accessed10 June 2015].

experts and M&A experts at the company's next annual meeting (Hoffman, 2013b). This served to intensify the pressure on the Board.

On 1 July, Burkle filed a complaint against OTK for using false and misleading proxy materials to take control of the Board and accusing it of misrepresenting the recommendations of two outside firms, ISS and Glass Lewis Company[36] (SEC, 2013P).[37] After a quiet month, turbulence continued at the troubled company until the 30 August when MOR announced the departure of its CEO, Michael Gross, by entering a separation agreement with him and subsequently appointing Kalisman as CEO on an interim basis (King, 2013; SEC, 2013Q[38]). Shortly after the appointment of the interim CEO, on 5 September 2013, KCM sent a letter to shareholders indicating its intention to nominate a separate set of directors to the Board at the 2014 Annual Meeting, arguing that: '*the current directors of Morgans Hotel do not adequately represent the interests of the majority of Morgans' shareholders*' (SEC, 2013R)[39].

They believed that OTK's views were over-represented on MOR's Board, while the views of the other 85% of shareholders were under-represented. KCM further expressed its belief that MOR should initiate an immediate public sale process to sell the company to one or multiple strategic acquirers (SEC, 2013R). Before KCM's letter to the Board, the fund had increased its number of shares from 243,391

[36] Leading independent provider of global governance services.
[37]SEC (2013o) Form SC 13D/A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1015899/000110465913053201/a13-15181_1sc13da.htm [Accessed 10 June 2015].

[38]SEC (2013p) Form 8-K [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513354885/d591187d8k.htm [Accessed 10 June 2015].

[39]SEC (2013q) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312513357735/d594159ddfan14a.htm [Accessed 12 June 2015].

(approximately $1.35 million) to 1,286,457 (approximately $10.4 million), an increase of approximately 7.5% in terms of the share value.

In the beginning of September, Burkle and YC, demanded that MOR should find a buyer following the departure of the CEO. Writing a letter to the interim CEO, Burkle stated '*get Morgans on the market and sell it to an appropriate buyer*'. After losing his seat at the MOR Board in June 2013, Burkle saw the dividend rate on his $100 million in preferred stock jump 4% without a '*spot*' on the Board, and he said that the penalty was costing MOR shareholders $10,000 per day (Strickland, 2013). Burkle also mentioned in the letter that his observation rights, guaranteed by his debt position, were ignored.

Following Burkle's letter to MOR's interim CEO, YC filed a legal suit in a New York state court alleging that MOR reneged on the term of a $75 million investment agreement following a proxy battle and accused the company of violating the terms of an October 2009 share purchase agreement. In return, MOR was required to nominate someone selected by YC to its Board, or to allow the YC nominee to observe Board meetings and receive copies of key documents. YC suggested that MOR had refused to allow an observer to sit on their Board meetings, in retaliation for a pair of lawsuits filed by the private equity firm in the wake of the proxy battle (Stendahl, 2013). Burkle's assumed intention was the fact that he wanted to stop MOR's secret plans to refinance one hotel and sell another (Kosman, 2013).

YC sent another letter to MOR again urging a sale process to begin and increased transparency by the Board (SEC, 2013S).[40] Shortly after the letter, on 31 October, YC sent further correspondence to the Board expressing a desire to make a proposal to the Board to purchase the company for $8.00 per share (roughly $870 million), subject to due diligence and no material change in the company's financial position. YC also encouraged the company to seek other bids in order to ascertain if they could obtain a higher price (SEC, 2013T).[41] However, sources told the New York Post that Kalisman and MOR had rejected YC's offer (Cameron, 2013). According to Kosman and Whitehouse (2013) investors believed that the Board was not serious about selling the company, despite interest from strategic buyers. Burkle's view that MOR should be sold was supported by many traders who had bought shares in the company. The continuous pressure for the company's sale company could have brought higher returns to shareholders as property prices in this period continued to rise.

7.4.3 Period III: January 2014-December 2014

At the beginning of the year, MOR borrowed $450 million against two of its properties (the Hudson and Delano South Beach hotels) in a deal that it would help pay off most of the $220 million debt held by Burkle. According to Agnew, an analyst for MKM Partners, the refinancing put '*MOR in a position to sell one or two hotels or the whole company'* (Maurer, 2014a). The successful refinancing sparked a 5.2% rise in the company's shares on the same day, to $7.90. In addition, through the debt offering, Citigroup valued the properties at between $600 million and $640 million, well above

[40] SEC (2013r) Form SC 13D/A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1015899/000110465913075864/a13-22337_1sc13da.htm [Accessed 12 June 2015].

[41] SEC (2013s) Form SC 13D/A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1015899/000110465913080097/a13-23392_1sc13da.htm [Accessed 12 June 2015].

the consensus $550 million valuation (Kosman, 2014a). On 28 February, MOR, OTK as well as several other associates entered into a binding Memorandum of Understanding with YC providing for the settlement of all litigations involving affiliates of the YC (SEC, 2014D).[42]

Following MOR's refinancing, a few weeks later, on 12 March, KCM delivered a letter to MOR and to the company's shareholders announcing their intention to nominate seven individuals for election to the Board at the 2014 Annual Meeting of Shareholders in May 2014. The letter cited the immediate sale of the company at the highest price possible as well as corporate governance issues that had resulted in reduced transparency and communication (SEC, 2014E).[43] Sources close to the situation said, '*he is making the rounds*', letting shareholders know (Kosman, 2014b). Adrangi said that his nominees, if elected, would hire a bank, run a sale process, and would take the best price for the company. MOR's shares were trading at $8 a share during that week, up about 0.4% and Adrangi felt that the run-up in the shares since the beginning of 2014 had been due to sale speculation (Kosman, 2014c). KCM's letter was acknowledged by MOR who stated that '*KCM would propose the liquidation of MOR prematurely and categorically and would rob MOR shareholders of the value that rightfully belongs to them*' (SEC, 2014F).[44]

[42]SEC (2014d) Form 8-K [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312514079034/d687375d8k.htm [Accessed 12 June 2015].

[43]SEC (2014e) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000092189514000530/dfan14a00322mor_03122014.htm [Accessed 12 June 2015].

[44]SEC (2014f) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312514105466/d695924ddefa14a.htm [Accessed 13 June 2015].

Even though KCM had been previously involved in activism in other companies, Agnew, a senior analyst at MKM stated that his understanding was that some investors did not believe that the KCM panel was strong enough (Maurer, 2014a).

On 2 April, KCM sent a letter to the Board highlighting the qualifications of its director nominees and stating that they were committed to exploring strategic alternatives, including a serious consideration of selling the company to the highest bidder (SEC, 2014G).[45] On 16 April, MOR and KCM respectively filed their definitive proxy statements in connection with the 2014 Annual Meeting of Shareholders. MOR's letter highlighted the Board's significant improvement on areas such as strategy and performance and their continued commitment to maximising value for all shareholders. The letter also highlighted the fact that KCM's panel could permanently impair the company's value. MOR believed that KCM's slate was neither incentivised to act in their best interest nor capable of achieving the greatest value for their investment and KCM was looking for attention and publicity, rather than economic incentives (SEC, 2014H).[46]

On 22 April, in a presentation made to ISS, MOR presented the actions and improvements of the Board over their tenure prior to the Annual Meeting of Shareholders (SEC, 2014I).[47] MOR stated that they had delivered on all promises

[45]SEC (2014g) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000092189514000712/dfan14a09892002_04022014.htm [Accessed 13 June 2015].

[46]SEC (2014h) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312514145143/d713089ddefa14a.htm [Accessed 13 June 2015].

[47]SEC (2014i) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312514153230/d714586ddefa14a.htm [Accessed 14 June 2015].

made: i) In ten months, the Board had overseen improved earnings, ii) the successful refinancing of two hotel properties on attractive terms provided the company with improved liquidity and reduced risk at the corporate level, iii) MOR was on track to be cash flow positive at the time and iv) there was a detail - oriented focus on the operational performance of the business (SEC, 2014J).

On the same date, KCM announced that they had retained Andrew Zobler, CEO and founder of the Sydell Group, as an advisor in connection with its efforts to evaluate strategic options at MOR, including the sale of the company (SEC, 2014J).[48] Burkle and KCM were in talks and it appeared at the time that Burkle supported KCM's proposed nominees as both entities supported selling the company with immediate effect. In addition, Zobler who was an advisor with KCM, had previously been a partner with Burkle and YC on several joint ventures (Maurer, 2014b). KCM also made a presentation to ISS in connection with the forthcoming annual meeting. In their presentation, they criticised the Board for failed performance (SEC, 2014K).[49] Key areas highlighted in the presentation were:

1. MOR continued to underperform peers since OTK had assumed control, and as a standalone business, MOR had continually underperformed.
2. OTK had failed to hire an experienced management team.
3. MOR had failed to unlock value by selling owned assets at market value.
4. Balance sheet issues remained a concern.

[48]SEC (2014j) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000092189514000876/dfan14a09892002_04222014.htm [Accessed 14 June 2015].

[49]SEC (2014k) Presentation to ISS [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000092189514000865/ex991dfan14a09892002_042114.pdf [Accessed 14 June 2015].

5. The share price at the time was supported by expectations of a sale transaction.

6. The standalone value was substantially less than a potential sale price.

7. MOR unilaterally increased the Board's size just 40 days prior to the Annual Meeting and after the record date (SEC, 2014K).

Prior to the company's annual meeting, on 24 April, MOR entered into an amendment to the Shareholder Rights Agreement to accelerate the expiration date of the Shareholder Rights Agreement from 9 October 2015 to 24 April 2014. The amendment had the effect of terminating the Shareholder Rights Agreement and all the rights distributed to shareholders pursuant to the Shareholder Rights Agreement would expire (SEC, 2014L).[50] On 1 May, MOR issued a press release in which it announced that ISS had issued a report advising MOR's shareholders to vote for seven of MOR's nine director nominees and withhold on director nominees Michael Olshan and Andrea Olshan (OTK's directors). ISS also recommended that shareholders should not vote for any of the seven nominees set forth by KCM (SEC, 2014M).[51] In the meanwhile, days after ISS's report, another advisory firm, Glenn Lewis & Co. LLC, issued a report in which they recommended that MOR shareholders should vote in favour of the two director nominees that were suggested by KCM. MOR, in a press release, disagreed with Glenn Lewis' analysis and recommendations and urged all shareholders to vote for its qualified nominees (Rodriguez, 2014; SEC, 2014N[52]).

[50] SEC (2014l) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312514157351/d718005ddefa14a.htm [Accessed 14 June 2015].

[51] SEC (2014m) Form SC 14A [Online]. Available at https://www.sec.gov/Archives/edgar/data/1342126/000119312514177409/d717168ddefa14a.htm [Accessed 14 June 2015].

[52] SEC (2014n) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312514183848/d722854ddefa14a.htm [Accessed 14 June 2015].

On 7 May, KCM issued a press release claiming that ISS and Glen Lewis had acknowledged MOR's years of underperformance and corporate governance issues. KCM presented statements from both companies that outlined the Board's weaknesses at the time. For example, ISS noted that MOR should hire a new CEO who would oversee the company's effort to improve its performance. In addition, Glass Lewis stated that *'...since the current Board came into office on June 14, 2013, the company's share price has been down as much as 15% and up as much as 12%, but through April 30, 2014, was up only 0.4%*' (SEC, 2014O).[53] On the same day, YC sent a letter to MOR's Interim CEO outlining repeated failures by the company to honour certain investor observation rights (SEC, 2014P).[54]

On 13 May, MOR issued a press release in which it disclosed that at the beginning of the year, the Board had again formed a special transaction committee to evaluate a full range of strategic alternatives, including the potential sale or merger of the company. In addition, the Board had retained Morgan Stanley & Co. LLC to serve as its financial advisor to assist the company in exploring strategic alternatives (SEC, 2014Q).[55] MOR's shareholders elected seven of the company's director nominees and two of the Kerrisdale director nominees as directors at the 2014 Annual Meeting (SEC, 2014R).[56]

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[53]SEC (2014o) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000092189514001013/dfan14a09892002_05072014.htm [Accessed 14 June 2015].

[54]SEC (2014p) Form SC 13D/A [Online]. Available at: https://www.sec.gov/Archive/edgar/data/1015899/000110465914036026/a14-12273_1sc13da.htm [Accessed 14 June 2015].

[55]SEC (2014q) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312514197274/d727134ddefa14a.htm [Accessed 14 June 2015].

[56]SEC (2014r) Form 8-K [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312514206556/d729314d8k.htm [Accessed 14 June 2015].

On 14 June, Mahmood J. Khimji who was nominated to the Board by OTK's panel, provided notice to MOR of his intention to resign from the Board. Prior to Khimji's resignation, there were speculations that Kalisman, MOR's interim CEO was considering a merger with Highgate Holdings where Khimji was CEO. In the case of a successful merger, sources stated that Khimji would become MOR's new CEO (DiChristopher, 2014). Following this event, Derex Walker also provided notice to MOR of his resignation from the Board of Directors (SEC, 2014S).[57] Walker had been a transaction partner at YU since January 2006 where he had played a key role in several of YU's investments.

On 9 October, according to the New York Post, MOR was looking to sell one of its properties, the Hudson Hotel, for an estimated $500 million. The company was also looking to sell another property, the Delano South Beach. The company retained Morgan Stanley as an advisor to proceed with the sales that were estimated to be a combined $700 million (Moses, 2014). In addition, on 16 December, MOR disclosed that they had entered into an equity purchase agreement with Hakkasan Holdings LLC, pursuant to which MOR agreed to sell its 90% interest in the Light Group to Hakkasan (SEC, 2014T).[58]

[57]SEC (2014s) Form 8-K [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312514340469/d788712d8k.htm [Accessed 14 June 2015].

[58]SEC (2014t) Form 8-K [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312514443916/d837802d8k.htm [Accessed 14 June 2015].

7.4.4 Period IV: January 2015-December 2015

During a quiet first quarter, on 2 February, YC sent a letter to the company designating Mr Bradford Nugent as the investor's nominee to the company's Board pursuant to the purchase agreement (SEC, 2015H).[59] On 20 March, Opiatowski, an analyst at APB Financial Group suggested that the time had come for MOR's sale. The analyst increased the buyout target to $14 per share from $12 per share. She believed that MOR was a different company compared to a year ago, stating that: '*the company went from bleeding cash, ensnared in lawsuits, and expense-heavy to running like a skilled boutique hotel operator'*. On 13 March, the company reported full-year earnings in EBITDA of $55.1 million from $52.2 million the previous year. The company had $1.4 million in operating income in 2014, compared to negative $1.9 million in 2013 (Brown, 2015).

On 3 April, MOR' increased the size of the Board from nine to 10 directors and appointed Bradford B. Nugent to fill the vacancy. On 15 April, MOR sent a letter to its shareholders informing them to elect 10 directors to serve one-year terms expiring in 2015 (SEC, 2015I).[60] However, on 18 May, Kalisman provided notice to MOR of his resignation as the company's interim CEO, so that he could focus on personal matters. Kalisman would remain a member of the company's Board and the Board's Special Transaction Committee. In connection with his resignation, the company announced that Richard Szymanski (who had served as MOR's Chief Financial Officer since 2015)

[59]SEC (2015h) Form SC 13D/A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1015899/000110465915005977/a14-25239_1sc13da.htm [Accessed 3 February 2016].

[60]SEC (2015i) Form SC 14A [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312515131270/d852951ddef14a.htm [Accessed 3 February 2016].

would temporarily serve as CEO (SEC, 2015J).[61] The company also announced the appointment of Howard Lorber (as Chairman) who mentioned that: '*Going forward, we will continue to build on our operational momentum and complete the strategic alternatives process in a timely manner*' (Cameron, 2015)

Lorber was president and CEO of Vector Group Ltd that was a major shareholder in MOR with a 7.4 per cent stake. On top of Lorber's appointment, MOR had appointed Jonathan Langer, a former Goldman Sachs real estate executive, who was also a former Board member, to work as a consultant to the Board's Special Transaction Committee. Following the above appointments, Opiatowski argued that because Langer and Lorber were known for being 'transactional' and 'getting things done', a deal to sell the company or part of it was close (Solomont, 2015).

On 6 August, sources revealed that SBE was close to an agreement to merge with MOR, but none of the involved parties commented on the matter (Brandt, 2015). However, the potential merger between them was challenged after RH offered to buy two hotels for $507 million in cash. RH criticised the possible merger, suggesting that a better way to maximise the shareholder value would be for MOR to sell the hotels and the management company separately. RH noted that almost all major shareholders of the company communicated to the Board (both verbally and in writing) the lack of enthusiasm and disapproval of the potential transaction with SBE (Mashayekhi, 2015).

[61] SEC (2015j) Form 8-K [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312515193599/d928582d8k.htm [Accessed 3 February 2016].

The possibility of the merger broke down on 31 October after a disagreement between Burkle and Kalisman. This resulted in MOR's share hitting a low of $0.79 per share in the following February. Burkle, a strong proponent of the deal, would have become chairman of the combined company, he would have acquired two MOR hotels and he agreed to give up his preferred equity stake ($130 million) in the company, which included extensive veto rights over sales and acquisitions. On the other hand, Kalisman opposed the deal, saying that the Board would cede too much control of the company to Burkle. The merger would have created a company, to be called SBE-Morgans, with a market capitalisation of $260 million. At the time, MOR was valued at around $120 million with $500 million in debt (Stulberg, 2015).

On 4 November, MOR issued a press release announcing its financial results for the quarter ended 15 September 2015. MOR announced further changes to its Board as Olshan (OTK's co-founder) was appointed a Board member to fill a vacancy that was created because of a member's resignation a few days before. In addition, the company announced the appointment of Adam Stein (portfolio manager of Pine River Capital Management that owned 9 per cent of MOR) because of the resignation of Brecker (KCM elected nominee) (SEC, 2015K).[62]

7.4.5 Period V: January 2016-December 2016

In the beginning of 2016, MOR was still looking to sell two of the properties not sold previously. While its share had collapsed during 2015, Walker (2016) believed that selling these assets could result in a '*serious upside for investors at today's prices*'.

[62] SEC (2015k) Form 8-K [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312515366224/d53266d8k.htm [Accessed 3 February 2016].

He further added that the strong demand for real estate properties in prime markets, could lead to robust auction for the assets. At the end of January, RH sent a letter to MOR and expressed '*serious concerns about the strategic direction of the company*'[63] and suggested steps to reform MOR's troubled governance (Mashayekhi, 2016b). RH's letter addressed to MOR's Board, indicated that the company '*is now facing a crisis*' that had seen its share price drop to $1.69 a week before. In the letter sent to the Board, RH made the following recommendations for: i) the Board to host an investor conference call to update shareholders on its strategic plan and why MOR had been unable to reach agreement with any industry partners over a potential sale of the company and ii) the Board to hire new independent financial and legal advisors to help with finding potential strategic partners (Mashayekhi, 2016c).

After a long-standing conflict, on 9 May, MOR had entered into an agreement and plan of merger with SBEEG Holdings, LLC. Under the deal, SBE acquired MOR for $2.25 per share, even though a week before the shares were trading as low as $1.33 before jumping on speculation of a takeover. The deal valued MOR at $82 million in equity value and would create a hotel management company with a total value of around $800 million. SBE's founder, Nazarian, would serve as CEO and retain majority control of the combined company, while Burkle and YC, who held a $75 million preferred equity stake in MOR, would obtain a 25% equity interest in SBE. SBE would acquire

[63] In its 2016 Annual Report, MOR expected to focus its business on an asset-light, brand-centred model with lower leverage. MOR intended to achieve growth primarily through the pursuit of new management agreements and, in select situations where they believed third-party managers had the experience and resources to satisfy its high branding standards, through franchise or licensing agreements.

all MOR’s hotel management brands (Karmin, 2016b; Mashayekhi, 2016d; SEC, 2016D[64]).

Shortly after the agreement, things took an unexpected turn as a securities law company (Rigrodsky & Long) was exploring potential legal claims against MOR’s Board that challenged the takeover. Rigrodsky & Long said in a statement that they were looking into ‘*possible breaches of fiduciary duties and other violations of law*’ related to the deal. The company was examining whether MOR’s Board failed to properly market the company and obtain the best possible shareholder value before making a deal, as they believed that the proposed buyout price was too low (Mashayekhi, 2016e). However, their investigation was triggered by MOR’s minority shareholders who argued in a class action filing that the deal undervalued MOR and unfairly benefited the controlling shareholder, YC. In the filing, attorneys for one of the minority shareholders argued that MOR failed to consummate a more attractive deal valued at around $6 per share. The lawsuit also alleged that Burkle had a longstanding personal and professional relationship with SBE founder, Nazarian and that ‘*self-motivated dysfunction*’ among other Board members had given YU disproportionate control (Montgomery, 2016).

On 12 May 2016, MOR held its 2016 Annual Meeting of Shareholders at which they elected the following nine directors: Andrew Board (KCM’s representative), Kenneth Cruse, John Dougherty (OTK’s representative), Jason Kalisman (OTK’s

[64]SEC (2016d) Form 8-K [Online]. Available at: https://www.sec.gov/Archives/edgar/data/1342126/000119312516584264/d184144d8k.htm [Accessed 6 January 2017].

representative), Howard Lorber (Vector Group's representative), Bradford Nugent (YU's representative), Michael Olshan (OTK's representative) and Michelle Russo and Adam Stein (portfolio manager of Pine River Capital Management) (SEC, 2016D).

Following the Board's election, in the beginning of September, a mystery bidder wanted to acquire MOR. MOR announced the revised offer from the bidder and delayed a shareholder vote on Burkle's bid until 26 September. Burkle bid $2.25 per share for MOR, approximately $800 million, whereas the rival bidder offered $2.75 per share (Putzier, 2016). However, on 28 September, MOR shareholders voted to approve SBE's acquisition of MOR, in a deal that was valued at around $800 million. Shareholders representing 71% of MOR stock voted in favour of the acquisition. Of the votes cast by shareholders, 98% were in favour of the buyout (Gourarie, 2016; King, 2016). The New York Post reported that MOR was '*thin on cash and needs to lock down a buyer or financing by the end of the year*' (Bockmann, 2016). Finally, the deal closed on 30 November and Burkle and SBE acquired MOR for $2.25 per share, or $805 million. YC and Cain Hoy Enterprises split a 50% stake with SBE retaining the other half. The extended company would have a portfolio of 22 hotels and YC and Cain Hoy would own $150 million of preferred shares in the new combined company. (Kosman, 2016).

7.5 Summary

This chapter has presented the research findings that emerged from the online documentary information and archival investigation of shareholder activism in MOR. OTK, YC, KCM and RH exerted substantial pressure on MOR's Board over an eight-year period, 2008-2016. During this period, all shareholder activists made numerous interventions to MOR’s Board of Directors, focusing on corporate governance matters and urging the Board to explore strategic alternatives such as the sale of the company. MOR attracted competitors who were interested in acquiring the company and shareholder activists because of the challenges that it faced in relation to corporate governance and poor financial performance.

The fact that all shareholder activists acted on a personal interest created tensions in the relationship between themselves and with the Board and some of the tensions were solved at federal courts. Compared to the other two cases, MOR was sold to one of its shareholder activist owners and their partners at a lower price per share than expected by all shareholder activists. Consequently, the remaining shareholder activists did not profit from their investment in the company. The next chapter presents the research findings from the three case studies in relation to the impact of shareholder activism through a complexity lens and in the context of outcomes emerging from the shareholder activism theory.

PART 3 - CONTRIBUTIONS AND CONCLUSIONS

The final part of the study brings together the research findings of the case studies and develops a deeper understanding of the impact of shareholder activism in corporate boards. It synthesises and discusses the findings derived from the cases in light of the study's research questions, corporate governance and complexity theory literature and the template framework in Chapter 4. Chapter 9 synthesises the key points and presents the contributions of this study and a number of recommendations.

CHAPTER EIGHT - ANALYSIS and DISCUSSION

8.0 Introduction

This chapter evaluates the Boards and shareholder activists as CCESs and addresses their interaction and interconnection with the agents that form their corporate governance ecosystem. It then investigates the impact of shareholder activism through a complexity lens, using the template created in Chapter 4. The chapter further discusses the journey of shareholder activists that begins from their entry and concludes when they leave their targets. The journey of shareholder activism led to the identification and discussion of four themes that relate to the intervention of shareholder activism – Board vulnerabilities, shareholder activist attacks, Board defence mechanisms and company changes (outcomes).

8.1 The Boards and Shareholder Activists as CCES

During shareholder activists' interventions, both Boards and all shareholder activists adapted and evolved, influenced by the changes caused by these interventions, and influenced all agents in their corporate governance ecosystems, eventually creating a new order (Mitleton-Kelly, 2006). As CCES, the Boards and shareholder activists exhibited the generic characteristics of complex systems suggested by Cilliers (1998) in Chapter 3. They consisted of multiple agents who were interrelated and interacted between themselves and their environments with limited local knowledge and influenced by their own personal agendas (e.g., Cascade's purchase of Four Seasons Punta Mita Resort from SHR). They adapted to the turbulence caused by activists' interventions and Boards' reactions. For example, they re-organised their internal structures (e.g., MOR's Board changes) and counteracted the opponents' actions (e.g., SHR's amendment to the company's shareholder rights plan).

The actions of shareholder activists and a multitude of positive and negative feedback processes (through public demands and statements, press releases and proxy fights) brought them into far from equilibrium states and forced them to use their dissipative structures (defence mechanisms explored in Section 8.6) in order to maintain their integrity as systems. Boards' behaviours were determined by their history as systems and their agents' history. For example, IHG's Board had long ago established an asset-light strategy that was used as a defence mechanism with the sale of Paris Le-Grand and InterContinental Hong Kong. In addition, prior to leading SHR, Raymond Gellein had a record of selling a public hotel company, which is what he did in the case of SHR.

Cilliers suggests that '*each element in the system is ignorant of the behaviour of the whole system; it can only act locally and only knows what goes on there*' (1998, p. 6). In disciplines such as biology, physics and chemistry, agents may be ignorant of the behaviour of the whole system; however, in a business context, agents behave differently. Both systems, the Boards and shareholder activists acted locally (e.g., Board meetings), but they also tried to influence the broader corporate governance ecosystem (financial analysts, media, proxy advisors and investors) to serve their interests. In that way, not only did they evolve by 'hill climbing' (Allen, 1994) adapting to the changes in their environment but as they moved along their fitness landscape, they altered the fitness landscapes of other systems in the broader corporate governance ecosystem (Kauffman, 1995). Although they were adapting to the changes caused by this continuous 'hill climbing', they were not just complex adaptive systems. Mitleton-Kelly (2006, p.230) argues that '*short-term adaptation may result in long-term co-evolution if the entities in due course influence and change each course'*.

The changes taking place in both systems did not happen in a vacuum, but they influenced one another as well as the rest of the corporate governance ecosystems, a process that fits Mitleton-Kelly's (2006) description of CCES.

8.2 Impact of Shareholder Activism through a Complexity Lens

Under the template framework, there are four stages that characterise the shareholder activists' journey that started with their advent in the target companies and concluded with their exit from their targets and the emergence of new order. Stage 1 addresses the initial conditions identified in the micro and macro environments of each company that led shareholder activists to demonstrate their interest in their targets. Stage 2 examines the Board's journey from near to far-from-equilibrium states looking at strange attractors, feedback processes, fitness landscapes and dissipative structures. Stage 3 explores the impact of shareholder activism and examines emergent behaviours such as self-organisation and exploration of the space of possibilities that leads to Stage 4, the emergence of new order.

8.2.1 Stage 1 Initial Conditions

The evolution of a complex system is sensitive to the environmental conditions that triggered its evolutionary trajectory (Mitleton-Kelly, 2003). The cases presented in the previous chapters showed that the conditions in the business environment at specific periods triggered the interest and facilitated the entry of shareholder activists in the corporate governance ecosystem of each case company. One environmental factor that facilitated the actions of shareholder activists were a series of regulatory changes (e.g., 1985, 1992 and 1996) that benefited hedge funds (Section 2.2.2). These regulatory changes allowed hedge funds and other institutional investors to scrutinise and publicly criticise, where appropriate, Boards and pool resources from investors without disclosing the source of their investments. By adopting the characteristics of each regulatory change, shareholder activists were able to enter each company with minimal effort and continue with their tactics to influence each Board's practices. Their entry may be a small change (e.g. another shareholder) for each company, but in a complex system like the Board it grew quickly and in large amounts due to the interest from media, a view confirmed by the literature (Mason, 2007).

Another environmental factor was the financial crisis that started in the US real estate market. What started locally had spread globally with unpredictable severity (Choi and Douady, 2009). The combination of the financial crisis and the regulatory changes enabled subsequently shareholder activists to lead the Boards to changes, a view that the literature characterises as the right kind of 'nudge' at the right time (Hendrick, 2009; Nilson, 1995). Before the shareholder activism events, all case companies were at a stage of recovery from the financial crisis and eventually they became a target for shareholder activists. This confirms Boyson and Mooradian (2012), Greenwood and Schor (2009) and Muhtaseb and Grover (2012) who suggest that poor financial and share performance are conditions that attract shareholder activists. Shareholder activists' primary emphasis is to focus on poorly performing companies and pressure the management of such entities to improve performance in order to increase their shareholder value (Gillian and Starks, 2000; Jiang and Anandarajan, 2009). All target firms were poorly performing in the aftermath of the financial crisis. Both SHR and MOR operated at a loss for several years and their share price showed a considerable decrease. On the other hand, IHG did not operate at a loss but the company's net income substantially decreased with a similar share price performance, thus becoming an appealing target for activists too.

As in other studies, activists were attracted to the case companies by vulnerabilities they identified in their corporate governance and asset valuation, aspects addressed in the literature review (Brav et al., 2008; Birstingl, 2016 and Lachapelle and Jinks, 2014). Section 8.4 discusses the vulnerabilities that are unique to each case company. Whilst, the other two sets of conditions that initiated shareholder activism were common to all case companies, it is these vulnerabilities that differentiated the most the co-evolutionary trajectories taken in each case. A slight change in the conditions at which a system's evolutionary process begins can lead through positive feedback to major changes in each evolutionary trajectory (Hendrick, 2009). Kernick (2004) argues our inability to measure initial systems conditions accurately and the extreme sensitivity of complex systems behaviour to these initial conditions make them unpredictable. Nevertheless, many complexity theorists (cited in Kuhn, 2009, p.57) maintain that even an approximate knowledge of a system's initial conditions can help in predicting the approximate behaviour of this system. Therefore, identifying these initial conditions was important in order to comprehend the different pathways the Boards followed in order to respond to activists.

8.2.2 Stage 2 - Far from Equilibrium

Before shareholder activists intervened in the ways Boards were running the case companies, all Boards had plans to improve the performance of their companies. Despite engaging with certain plans, their performance was not successful in most cases and financial analysts were not optimistic about their future. As a result, activists took the opportunity to intervene by acquiring sufficient stock to cause disruption between shareholders and the Boards. The further the system moves away from near equilibrium, the more it displays chaotic patterns of bounded instability (Stacey, 2003). As the disruption grew, Boards started moving from their near equilibrium state to far from equilibrium.

Another characteristic that pushed the Boards far from equilibrium were the strange attractors that were the result of the Boards interaction with shareholder activists. This supports Pascale et al.'s (2000) view that strange attractors do not occur in isolation, but they are the result of an interaction between an agent and its environment. Activists' demands for change in the case companies acted as strange attractors, which guided the Boards behaviours towards actions that would not take place in a near equilibrium state. In all companies, the activists' demands were related to strategic areas that if they were to be successful, would benefit both agents. For example, in case I, the strange attractor was OC's demand for SHR's sale by generating $11-$14 per share. A private equity company acquired SHR and its share price before its sale reached $10-$11 and eventually benefited OC's investment confirming Dai's (2013) and Levine's (2015) views that hedge fund activism tends to increase share prices. In case II, the strange attractor was the activists' assertion that the company could become a takeover target and would be more valuable if merged with or sold to a competitor. Despite several attempts by MCM, IHG remained a standalone company. In case III, the strange attractor was the potential sale of the group, a demand that was encouraged by all activists and led to MOR's sale. Under the guidance of the strange attractor, the system will allow change while trying to maintain some order (Mason, 2007).

When a strange attractor is introduced, the system applies dampening mechanisms (negative feedback) that minimise their effects and allow the system to explore its fitness landscape searching for an optimum position of stability (Gilstrap, 2005; Pascale et al., 2000). All Boards initially attempted to dampen the effects of shareholder activists' demands in order to maintain stability within their ecosystems. SHR rejected the proposal for the sale of the company and denied the allegations made by OC. This is why SHR responded to OC's demand stating that the fund was interested only in short-term gains. In IHG's case, the company's CEO appeared to keep an open mind about TFM's intervention by downplaying the fund as just 'another shareholder' and suggesting that anyone in the public could buy and sell the company's shares. When MCM made their own intervention to IHG, the Board responded by saying that the company would focus on pursuing their strategy at that time, ignoring MCM altogether. MOR's initial reaction with OTK's demand for a change in strategy was that the priority for the Board was to return the company to profitability. Therefore, in all cases, the Boards ignored the interventions trying to shift stakeholders' focus to their existing agendas. Even if the complex system resists the turbulence caused by increased energy and information within its broader environment and attempts to ignore the newly introduced strange attractor, the agents within it start exploring their fitness landscape for new 'local optima' with small incremental adjustments. Levinthal (1997) calls these adjustments 'adaptive walks' in the fitness landscape, especially if the peaks in this landscape are correlated i.e., high peaks are near other high peaks and no major changes are required. MOR's decision to establish a Special Committee to evaluate the sale of the company to YC is an example of such an 'adaptive walk'.

When the system starts to move far from equilibrium and explore its fitness landscapes, it still displays predictable patterns of behaviour (Pascale et al., 2000). Such patterns were observed in all three cases when companies disposed of some of their assets. However, while this behaviour was predictable, the outcomes of this behaviour were not always predictable. Although, SHR's sale of assets led to the decrease of the company's debt, it caused challenges in its corporate governance function where it was accused of transparency issues. IHG's asset disposal enabled the company to lower the activists' influence on other shareholders. On the other hand, MOR's asset disposal did not improve the company's share price and financial performance, which, in turn, increased the pressure from the activists.

As the pressure to the system increases, 'adaptive walks' are not effective anymore. Maturana and Varela (1987) contend that increased information and energy flows from the environment lead to behavioural iterations according to the system's own structure and meaning. These flows act as positive feedback mechanisms amplifying the disruption and thus contributing to further change and gradual disorganisation (leading to the edge of chaos). In such a position, the system starts behaving in often unpredictable and even chaotic patterns (Hendrick, 2009; Mason, 2007). With increased pressure from shareholder activists and other stakeholders, the Boards started using different defence mechanisms in order to restore stability. For example, SHR refinanced mortgages on some of its properties where the new owner would assume its debts. It also approved an amendment to the company's shareholder rights plan in response to OC's governance concerns. IHG employed the tactical defence of asset disposal and on two occasions, delivered dividends to the company's shareholders. MOR used presentations to investors to address concerns raised in

OTK's presentations to the same audience. The company also refinanced the mortgages on two properties in order to make the company attractive to potential buyers.

In the journey from a near to a far from equilibrium state, a complex system displays a property, which explains its transitions from one state to the other. Prigogine and Stengers (1984) talk about dissipative structures that import energy and information flows from the external environment and export entropy (a measure of disorder), thus, tending to stabilise the system and return it closer to equilibrium. This property maintains the integrity of the system, i.e., its deep structure (Hodge and Coronado, 2007). IHG's dissipative structure was able to maintain the deep structure of the system as it was reinforced by the disposal of assets, which in turn provided dividends to shareholders, the acquisition of Kimpton Hotels and Restaurants and the development of new brands. In that way, all investors benefited including shareholder activists who took advantage of the increasing share price and exited the company with a substantial profit.

When the dissipative structure of a complex system is not able to handle the energy and information flows anymore, the deep structure of the system collapses. The complex system, however, retains this property, which later forms the basis for its self-referencing processes needed for self-organisation (Hodge and Coronado, 2007; Smith, 1986). Consequently, in the other two case companies, the dissipative structures were seized to be able to manage energy and information flows, thus leading to the collapse of their existing Board structures. Despite the implementation of tactics by both SHR and MOR, their disadvantaged position due to loss of profit and governance issues did not convince activists and other stakeholders about their intentions.

8.2.3 Stage 3 - Edge of Chaos and Beyond

As complex systems move farthest from their equilibrium or from their near equilibrium states, they eventually enter a zone, which Stacey (2003) calls the 'zone of complexity' and Pascale et al. (2000) call 'the edge of chaos'. Continuous pressure from shareholder activists pushed all Boards in the case companies into this zone forcing them to find ways to respond to or reject their demands. In all cases, the Boards adapted, evolved and demonstrated flexibility in response to the activists.

SHR's continuous poor financial performance and the pressure from OC gradually pushed the company to the edge of chaos. OC sent a letter to SHR's lead independent director arguing that the sale process of one of the assets of the company to Cascade had been insufficiently marketed, having been exclusively negotiated with a major shareholder. The activist charged SHR with '*value destroying governance practices*' including problematic executive compensation, excessive corporate expenses – as a percentage of total revenue – and shareholder unfriendly defences owing to the fact that SHR did not hire an independent financial advisor to evaluate the sale of the resort. Following OC's allegations, SHR appointed one of the fund's representatives to the company's Board, which according to Boyson and Mooradian (2011), is one of the successes of hedge fund activists.

On the other hand, two events pushed IHG to the edge of chaos. Initially, MCM advised IHG to hire an independent financial advisor and conduct a full and formal evaluation of strategic alternatives and their impact on shareholder value stressing the timing of that period. Then, following IHG's response to MCM, Berenberg issued a buy note with a £27.50 price target and said that IHG could merge or take over another hotel operator but was more likely to be prey rather than the predator, with Starwood or Hilton as the most obvious acquirers. The second event led IHG to acquire Kimpton Hotels and Restaurants. Complex systems constantly adapt and evolve by self-organising and become flexible in their approach (Kauffman, 1993; Mason, 2007; Stacey, 1995).

As far as the third case in this study is concerned, at the beginning of 2016, MOR was looking to sell two properties to improve its financial performance. The company's share collapsed during 2015 and financial analysts believed that selling these assets could result in a '*serious upside for investors at today's prices*'. After a series of shareholder activists' interventions attacks, RH sent a letter to the company's Board by expressing concerns about its strategic direction and suggested steps to reform its troubled governance. RH offered to buy two hotels and proposed that the Board should host an investor conference call to discuss the reasons for not finding strategic partners to sell the company. In addition, it proposed that MOR should hire independent financial and legal advisors to assist in the process of finding strategic partners.

When a complex system reaches a point in which previous beliefs, interrelationships and practices cannot any longer function, its dissipative properties cannot maintain the integrity of its existing structure. This is a system breakdown point at which the system disintegrates and a return to its previous status becomes increasingly difficult (Seeger, Sellnow and Ulmer, 2003). At this point, which is also known as a bifurcation point (Haynes, 2014; Hendrick, 2009), there are several, perhaps many, possible paths for the system to follow and no way to predict which path will be taken.

Pushed to the edge of chaos, SHR responded to shareholder activists with a series of actions. However, it was the sale of the Four Seasons Punta Mita resort to Cascade, and the lack of transparency for this transaction that caused major distrust among the Board, thus weakening the Board's dissipative structures. OC's further pressure eventually led to SHR's Board bifurcation point where a re-structure was deemed necessary with the inclusion of OC's representatives on the Board. MOR's continuous poor financial performance caused disbelief among its shareholder base who voted in favour for OTK's panel of seven nominees to take control of the Board despite the proxy advisor opposing position. Not all systems disintegrate when reaching the edge of chaos. Those that manage to adapt and evolve in line with the changes in their environment can survive and even thrive in this zone (Stacey, 2003) just like IHG, which was transformed with the sale of assets and the development and acquisition of new brands keeping its Board structure intact.

Self-organisation is the property that complex systems display when driven far from equilibrium, and when they have gone through a radical shift i.e., the bifurcation point (Espinosa and Porter, 2011; Goergen et al., 2010). Crossing that point, new patterns of relationships emerge and the features of the system continually change until the new situation settles down with a new underlying form. Several complexity theorists view self-organisation as the '*transformative cause of emergent new directions in the development of the organisation*' (Stacey et al., 2000, p.123) which allows the organisation to be in constant renewal and to attain new forms of order and structure (Kiel, 1994, pp.173-199). Although the Boards in the three case studies tried to keep an ‘open mind’ to all activist interventions when crossing the several bifurcation points that emerged from these interventions, their agents ‘spontaneously came together’ to explore new solutions in an effort to establish a dynamic balance within the corporate governance ecosystem through a process that Pascale et al. (2000) call ‘episodic self-organisation’. Changes in the relationships between agents led to changes in the power dynamics within the corporate governance structure. MOR’s Board experienced the departure of some of their members as happened with the departure of Michael Gross and the appointment of Kalisman as CEO on an interim basis. Following this, further changes occurred in MOR where the company appointed Michael Olshan to its Board to fill a vacancy that was created by another resignation.

Pascale et al. (2000) also suggest that a form of self-organisation is the creation of alliances, partnerships and temporary project teams during the period of turbulence. When transitioning from bifurcation to bifurcation at the edge of chaos, agents within complex systems explore various alternatives and configurations, which ultimately, will enable them to choose and develop different structures (Mitleton-Kelly, 2003; Mitleton-Kelly and Papaefthimiou, 2002). The sale of the Four Seasons Punta Mita Resort to Cascade Investment, LLC, demonstrated SHR’s Board intention to receive support from the shareholder during shareholder activism. MOR’s agreement to merge with another operator resulted in the investigation of the transaction after the company’s minority shareholders argued about MOR’s value. These self-organising actions of the Boards were not imposed by anyone within the Board or outside and were neither designed nor an outcome of a strategic plan. They were the result of local interactions

(Boulton et al., 2015) between the Board members and/or with shareholder activists who were attempting to influence their respective companies.

Goldstein (1994, pp. 33-52) parallels self-organisation to participatory and democratic management practices. This view implies that self-organisation is a natural law, which almost inevitably, leads a complex system to an ‘optimal’ balance. However, the cases of shareholder activism investigated in this study show that optimal states emerged in limited instances. In all Boards, self-organisation did not lead to democracy and participation but to different hierarchical structures, some of which were not able to withstand the test of time.

In the self-organisation process, the Boards explored different alternatives in an attempt to maintain their status quo by keeping their shareholders satisfied and returning to near-equilibrium conditions. SHR’s Board reviewed an independent review of executive compensation and redemption of the company’s Series A Preferred Stock. Similarly, IHG during TFM’s activism monetised some of its real estate assets and returned dividends to its shareholders. During MCM’s shareholder activism, IHG continued to apply its asset-light strategy by selling key assets (e.g., Paris Le-Grand and InterContinental Hong Kong), acquired hospitality brands e.g., Kimpton Hotels and Restaurants, and returned dividends to its shareholders.

The result of complex systems’ self-organised processes is the emergence of new order (Goldstein, 1999; Medd and Haynes, 1998). In SHR, the new order came about with the company’s acquisition by the Blackstone Group and the fact that holders of shares of SHR’s common stock were entitled to receive $14.25 in cash for each share they owned. The outcome was OC's demand when entering SHR's ownership structure. In IHG, the new order was related to changes in the company's operating structure and the fact that the company remained standalone. The fact that the company had been involved in mergers and acquisitions in the past (up to 2003) did not influence its corporate structure. The conditions that enabled IHG to remain standalone were the company's asset-light strategy that strengthened its financial performance, the return of dividends to its shareholders and the fact that its leadership had been stable since 2005. In MOR, the emergence of new order was the sale of the company to another group (SBE). Prior to the company's sale, all shareholder activists were urging its sale.

The new order illustrates that the presence of a shareholder activist on the Board influences its future behaviour in favour of the activist's intentions. Despite any differences (that they may have), when shareholder activists have a simultaneous presence in a company, they will work together in order to accomplish their goals, especially if they have similar intentions (e.g., return on their investment). The emergence of new order in all case companies confirms the literature (Hendrick, 2009; Mason, 2007; Mitleton-Kelly, 2006) as some of the examples of emergence are new strategic developments, new structures and new cultures.

8.2.4 Shareholder Activism from a Complexity Theory Perspective

In all cases, the new order was not the result of a direct and linear causal relation between the Board's decisions and the activists' interventions. The analysis of the cases under the proposed template framework and through the complexity lens enabled an understanding of why the outcomes of shareholder activism often differ from initial expectations and can be unpredictable. The complexity lens applied in this study showed that uncertainty is inevitable and no party (Board, shareholder activists, financial analysts and other stakeholders) can appreciate how the governance ecosystem functions in its entirety.

The literature on corporate governance and shareholder activism has used theoretical models that looked at linear cause-and-effect relationships between constructs and agents. The discussion in this chapter showed that a complexity theory perspective offers researchers and practitioners a clearer understanding of the changes that are taking place in the corporate governance ecosystem because of shareholder activism. The differences in applying the complexity perspective to shareholder activism as opposed to a linear approach are summarised below (see Table 8.1).

Table 8.1 Shareholder Activism from a Linear Versus a Complexity Perspective

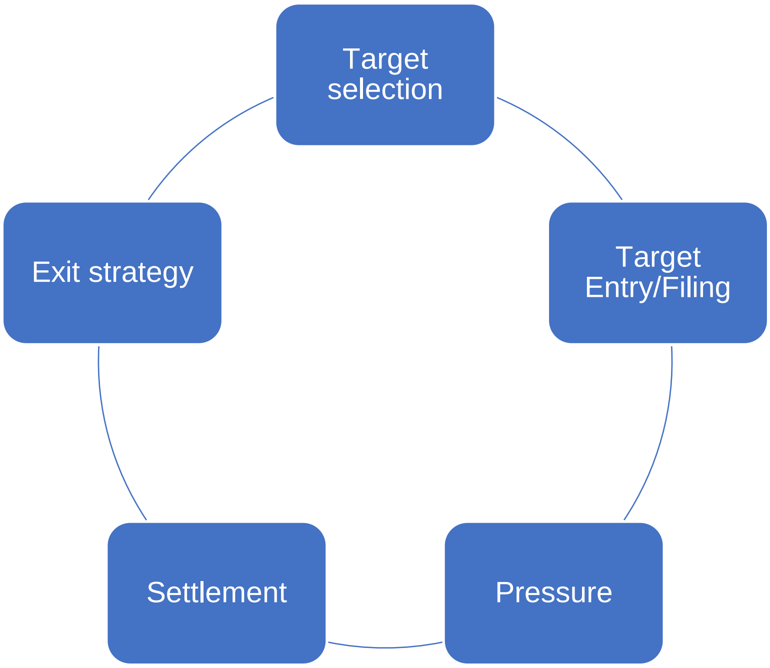
Shareholder Activism	Linear Perspective	Complexity Perspective
Assumptions on Board’s response	A well-structured system that consists of components such as executive members and non-executive members.	A dynamic complex system that consists of interacting and interdependent agents (Board members, primary and secondary stakeholders) that co-evolve with its environment.
	A system is managed and controlled by a top-down approach.	A complex system that evolves by both bottom-up and top-down approaches.
Board's Culture	The Board's culture is broken down into components (standards, values and the code of conduct, written and unwritten rules). The Board's chairman and the CEO influence the Board's behaviour.	Internal and external agents influence the Board’s culture. Stakeholders continuously interact with and challenge the Board's status quo. The interaction leads to emergent properties of the Board.
Business Environment	Near equilibrium conditions are the desirable state for the system. Any changes in the environment may move temporarily the system to far from equilibrium conditions but the ultimate goal is the return to the old status quo.	Stability is temporary, the system constantly co-evolves with its dynamic environment and explores the space of possibilities to re-configure itself and reach states of ‘new order’.

Shareholder activism causes Boards to operate in far-from-equilibrium conditions and, often, to behave unpredictably. By default, the Boards need to engage in non-linear responses and interactions to meet the challenges of their operating environment and this includes shareholder activism. However, their responses are directly related to the Board’s culture and how the Board will behave when attacked e.g., engage, reject or ignore shareholder activists’ demands. The Board will not be able to and may not return to its previous status quo and ultimately, shareholder activists will influence its behaviour and, in many cases, its structure.

8.3 The Journey of a Shareholder Activist

In all case companies, shareholder activists followed a systematic approach that demonstrates the steps that they took during their interventions (see Figure 8.1). The shareholder journey confirms Muhtaseb's and Grover's (2012) study on shareholder activists' engagement when they intervene in companies. Although two shareholder activists (OTK and YU) had not engaged with activism before, they adopted similar tactics to the ones that established shareholder activists apply in the business environment.

Figure 8.1 Shareholder Activism Journey



The first step of the shareholder activists' journey is related to the selection of the target company. Activists undertake research and identify their targets based on vulnerabilities that they display (Section 8.4) and shortly after, their intervention begins with the acquisition of stock. The literature review suggests that shareholder activists usually enter their targets with a representative 5% ownership (Muhtaseb and Grover, 2012). However, with the exception of OTK and YC, who acquired a stake of more than 5% in their targets, all other shareholder activists did not exceed the 5% threshold and did not file their investments (see Table 8.2). Unlike all other shareholder activists, OTK and YC were not active activists and their interventions in MOR began approximately four years after their entry into the company.

Table 8.2 Initial Stake of Shareholder Activists in Targets

Company/Target	Activist	Date bought shares for the first time	% of shares bought
Strategic Hotels & Resorts	Orange Capital (OC)	March 2013	4%
Morgans Hotel Group	OTK Associates (OTK)	January 2008	14%
Morgans Hotel Group	Yucaipa Companies (YC)	November 2009	28%
Morgans Hotel Group	Kerrisdale Capital Management (KCM)	February 2013	4%
Morgans Hotel Group	Rambleside Holdings (RH)	Before August 2015	4%
Intercontinental Hotels Group	Trian Fund Management (TFM)	May 2012	Approximately 4.27%
Intercontinental Hotels Group	Marcato Capital Management (MCM)	May 2014	Approximately 3.8%

Following the filling of their ownership or share acquisition, proactive activists start exerting their pressure on the Board, which is usually done with an email, statement, telephone call, press release or an open letter to the Board and the shareholders (Armour and Cheffins, 2009). All shareholder activists communicated their investment goals and intended to influence the Boards and their companies. Activists use their ownership status to influence policies and practises in companies (Judge et al., 2010).

Eventually, OC issued a press release to inform the public about their ownership status in the company, while MCM issued a statement disclosing their proposal about IHG's strategic direction. In MOR's case, both KCM and RH sent an open letter to MOR's Board expressing their concerns about the company and urging the company to consider strategic alternatives about its future.

When the initial pressure does not yield the desired results, shareholder activists mount their pressure in the form of criticism, letters, public arguments, presentations, proxy fights and litigations (Cheffins and Armour, 2011; Hilldrup, 2013). All shareholder activists employed these tactics to intensify their pressure on the Boards. OC publicly criticised SHR for their decision to sell one of their assets to another shareholder of the company, whereas, MCM released a letter to IHG's shareholders presenting their evaluation potential of strategic alternatives about the company. In MOR, shareholder activists such as OTK made a presentation to investors and proxy advisory firms addressing their concerns and YU filed a litigation towards the Board, as it did not invest as claimed in the company. In addition, all shareholder activists issued letters as a form of pressure to the Board and shareholders for reasons related to the governance and financial performance of the companies.

In two cases, the mounting pressure resulted in negotiations between shareholder activists and the Boards. SHR and OC negotiated the appointment of David W. Johnson to the company's Board of Directors. Johnson's appointment led OC to withdraw its notice of nomination of their director candidates to SHR's Board and to agree to a customary standstill provision. Similarly, in MOR, OTK and KCM negotiated with the company the possibility of taking full control of the Board while YC proposed the nomination of one its representatives to the company's Board. This contradicts the literature review, as activist hedge funds do not usually seek control of target companies. Instead, they rely on cooperation from management or in its absence, support from shareholders to implement their value-improving agendas (Dai, 2013). Having made negotiations with both companies, shareholder activists managed to secure seats on the Boards of Directors. Hedge fund activists achieve Board representation in 69% of their targets in a study conducted by Boyson and Mooradian (2011).

In the final step of their journey, shareholder activists exited their targets but not all of them met their goals in terms of their investment return. OC exited SHR after the company's share price had increased substantially ($11.22) since their entry ($6.70). Their short-term interest that led to SHR's increased share price benefited the company's shareholders, a consequence discussed by Tricker (2012b). In IHG, only TFM benefited from their investment in the company as the share price of the company had increased during their presence, while MCM did not increase the returns on their investment. In MOR, all shareholder activists had losses on their investment in the struggling hotel group. In addition, not all target companies accepted their shareholder activists' proposals. OC's intention for SHR's sale was finalised a year after OC's exit from the company. TFM's and MCM's intentions for IHG's takeover by a competitor did not occur and IHG remained a standalone company. However, in both activist interventions, IHG continued its asset-light strategy by monetising their assets and by paying dividends to their shareholders, something that hedge funds tend to favour. On the other hand, MOR's Board incorporated shareholder activists' proposals for the sale of the company.

8.4 Board Vulnerabilities

Prior to attacking each Board, shareholder activists identified vulnerabilities in their targets. Three vulnerabilities emerged from the cases and they were as follow:

1. Poor corporate governance practices such as violations of investor trust, problematic executive compensation and excessive corporate expenses and reduced transparency and communication.
2. Poor financial performance of the target company.
3. Undervalued portfolios of assets including large cash positions.

The findings confirm the literature on shareholder activism as activists usually acquire stakes in companies with weak corporate governance or which they believe are undervalued (Greenwood and Schor, 2009; Lachapelle and Jinks, 2014; Muhtaseb and Grover, 2012). In addition, hedge fund activists tend to target companies with low market value relative to book value, although they are profitable with sound operating cash flows and higher leverage (Brav et al, 2008). Targets of shareholder activists also have also operating performance, larger cash positions and lower sales (Boyson and Mooradian, 2012; Gillian and Starks, 2000; Jiang and Anandarajan, 2009).

Improving financial performance and effectively managing a well-known brand portfolio proved to be challenging for both SHR and MOR. Prior to OC's intervention in 2013, SHR was running at a loss while MOR was consistently underperforming over the course of shareholder activism. On the other hand, IHG's large size (both in terms of assets and annual revenue generation) and the lack of significant financial challenges, were an opportunity for shareholder activists to increase the company's shareholder value. Unlike SHR and MOR, IHG's undervalued portfolio was a concern for both activists. Another vulnerability that both shareholder activists addressed in IHG's case was the company's large cash position. During TFM's tenure, the company paid dividends to its shareholders. In situations where companies have excess cash available, the hedge funds will lobby the company to engage in one-off dividend distribution to shareholders (Kahan and Rock, 2009). Although TFM did not publicly demand from IHG to pay dividends to its shareholders, its history of successful interventions must have prompted the company to pursue this path. The identified vulnerabilities reflected the Board's practices and gave leverage to activists to exert pressure on each Board and ultimately, drive them into far-from-equilibrium states.

A vulnerability addressed in the literature is associated with leadership stability in the case companies and the impact it had on activists' interventions. MOR was constantly searching for a permanent CEO to lead the company and on several occasions, shareholder activists suggested the replacement of its CEO. The continuous pursuit to find the 'right' leader led to the governance challenges the company faced and which was raised by activists. Activist hedge funds may propose a company to replace their CEO (Bebchuk et al., 2015) and the literature (Cheffins and Armour, 2011; Gantchev et al., 2017) suggests that activists interventions increase CEO turnover by 10%. In contrast, IHG demonstrated stable leadership for a long period, had a clear strategic plan and the Board and shareholders seemed to trust the company's CEO. In addition, IHG's leadership publicly engaged with both activists' demands and media speculations on the success of past activists' interventions. Previous successes of activists have even made the most confident CEOs engage with them leading to settlements either before or after a proxy contest (Goldberg and Nathan, 2017).

8.5 Shareholder Activist’s Attacks

Following their initial entry and filing of their investments, shareholder activists employed tactics in order to support their agendas. Most activists in these cases initially urged all Boards to either sell their companies or part of them (see Table 8.3). The sale of a company is one of the main aims of shareholder activists when they enter a company (Bebchuk et al., 2015; Greenwood and Schor, 2009; Pearson and Altman, 2006). In addition, the sale of a target was one of the main demands of activists in a study conducted by Birstingl (2016) during the period 2014-2016. Other demands were related to the full control of MOR’s Board and the prospect of IHG’s merger with another company. The demands in all case companies were part of the tactics employed by activists in this study.

Table 8.3 Initial Demands

Company	Activist	Initial demands made by the activist	Method of communicating
Strategic Hotels & Resorts	Orange Capital (OC)	Demanded a sale of the company	Letter to the board/Publicly
Morgans Hotel Group	OTK Associates (OTK)	Takeover of the Board	Letter to the Board
	Yucaipa Companies (YC)	Proposals to acquire a number of MHG’s assets in exchange for YC’s various holdings in the group	Board
	Kerrisdale Capital Management (KCM)	Demanded a sale of the company	Letter to the Board
	Rambleside Holdings (RH)	Pushed for hotel assets to be sold and the separation of the management company	Comment on the Board
InterContinental Hotels Group	Trian Fund Management (TFM)	TFM would probably be looking to push IHG to sell more of its owned and operated hotels	Analysts' speculations
	Marcato Capital Management (MCM)	Prospect of a merger	Comment on the Board

Following their initial demands, shareholder activists employed tactics in order to influence each Board's agendas and practices. In all cases, these tactics displayed similarities and activists employed them during their interventions (see Table 8.4).

Table 8.4 Shareholder Activism Tactics

Strategic Hotels & Resorts	**InterContinental Hotels Groups**	**Morgans Hotel Group**
Orange Capital	**Marcato Capital Management**	**OTK, Yucaipa Companies, Kerrisdale Capital Management, Rambleside Holdings**
Publicly communicate their intentions	Publicly communicate their intentions	Publicly communicate their intentions
Increase ownership	Hired an advisory bank	Demand negotiation
Demand negotiation	Letter to shareholders	Board representation
Press release	Website establishment	Letter to shareholders
Website establishment	Increase ownership	Litigations
Add experienced Board members	Demand negotiation	Presentation to investors
Exit	Exit	Proxy fight
		Support from proxy advisory firms
		Exit

With the exception of TFM which remained silent and whose intentions were based on analysts' speculations, all activists approached the Boards in communicating their initial intentions after the stock acquisition and before moving on to implement several different tactics. Proactive hedge funds activists usually probe management with a phone call, e-mail or letter, urging management to agree to implement the hedge fund's proposal designed to increase shareholder value (Armour and Cheffins, 2009). Following their initial contact, activists increased their pressure on the Boards, as they did not receive a response. This supports the literature review, as activists will become more hostile in the event that managers resist their appearance (Kruse and Suzuki, 2012) and this contradicts Brav et al.'s (2015) study where only 30% of the engagements in their sample were hostile requiring an actual or threatened proxy contest, a takeover threat, litigation, or confrontational public statements.

OC made a letter public due to SHR's Board's failure to provide an adequate response to its initial letter. After IHG denied certain tactics employed by MCM, the fund hired an advisory bank (Houlikan Lokey) to find a US buyer for a strategic review of the business. All shareholder activists attempted to negotiate their position by sending several letters to the Boards at different periods criticising the companies. Not having influenced the Boards, shareholder activists escalated their pressure by employing additional tactics.

It is evident from all cases that shareholder activists studied carefully their targets. Some of their media campaign tactics (presentations and creation of websites) were thorough and gained interest from the financial media and analysts. Activists will use public relations, social media and traditional media campaigns to establish their arguments (WLRK, 2019). OC and MCM established websites where they presented their proposals for the future of their targets. The presentations were made available to all shareholders, investors, and other stakeholders such as analysts and media. Subsequently, both activists increased their ownership as a form of pressure on the Boards and remained their top shareholders. Other shareholder activists (OTK) delivered a presentation to investors and proxy advisory firms (ISS) addressing several concerns – MOR's share price performance and the composition of its Board of Directors. The activists' tactics in this study demonstrate that hedge fund activism is firstly about creating value and secondly about governance (Bratton, 2010).

Proxy fight was another tactic employed by shareholder activists in one case company (MOR). The activists were looking to solicit support from the company's shareholders regarding their intentions. Brav et al. (2015) characterise some engagements as 'openly hostile', involving an actual or threatened proxy contest. The threat of a proxy contest is, perhaps, the most important weapon the activist hedge fund has in its possession to drive change (Sharfman, 2015). Proxy fights were only evident in MOR's case from several activists. In one instance, YC filed a complaint against OTK for the use of false and misleading proxy material with the intention of controlling the Board and accused OTK of misrepresenting recommendations made by ISS and Glass Lewis Company.

Shareholder activists exited their investments in various ways. OC exited its investment after placing one of its representatives on the company's Board and after the fund agreed to a customary standstill provision. The proxy battle between KCM and MOR's Board was followed by a series of events between the agents that led to the company's sale. Unlike the above, in IHG, MCM exited the company after their tactics did not have much effect on the company's strategic direction and resulted in loss for their investment.

8.6 Board's Defence Mechanisms

The advent of a shareholder activist in a company usually triggers a wide range of Board defence mechanisms (see Table 8.5). There are Boards that will initially engage with a shareholder activist and then move into denial and other Boards that will initially be defensive and negative and then engage with shareholder activists. Boyson and Pichler (2017) argue that target companies do not typically embrace the advent of an activist, since dealing with them can be costly and time consuming. According to them, a target company may engage, not in public dialogue but in private negotiations with activist hedge funds, something that this study did not corroborate, perhaps, because such negotiations are usually not publicised.

IHG's Board initially engaged with the media and shareholder activists and then denied the proposals made by the activists for the company's merger with another operator. Although the Board denied the proposals made, it followed other defence mechanisms e.g., tactical, that benefited both shareholder activists and shareholders. The other two Boards were negative (did not respond and disagreed) to shareholder activists' initial and subsequent communication; however, due to their vulnerabilities, they eventually had to engage with activists' intentions and tactics.

Table 8.5 Board's Defence Mechanisms

Strategic Hotels & Resorts	**InterContinental Hotels Groups**	**Morgans Hotel Group**
Disagreement with shareholder activists' proposal	Media engagement	Disagreement with shareholder activists' proposal
Engagement on shareholder activists' proposals	Tactical defences (assets sale, dividends pay to shareholders, acquisition and creation of brands)	Engagement on shareholder activists' proposals
Tactical defence (assets sale)		Media campaign (presentation to investors, press release, letter to shareholders)
Legal defence (poison pill amendment)		Tactical defence (refinancing)
		Legal defence (poison pill amendment)

Disagreement on the initial shareholder activists' demands was publicly communicated by SHR's Board in response to OC, stating that the Board disagreed with certain assumptions and conclusions made by the fund. However, the Board remained open for discussion leaving a window for engagement with the activist. The response escalated OC's pressure and led to a further response from the Board rejecting suggestions about the sale of the company that the fund made and disagreeing with their views. IHG remained silent in the initial demand made by MCM, but then the Board engaged in a dialogue with the activist investor and claimed they were open to their suggestions. However, they then disagreed with MCM's takeover intentions and claimed they were confident in pursuing their own strategy for high quality growth and delivering financial performance.

MOR's Board was operating in a more complex situation and had to deal with four activists who already held positions on the Board at different times. The Board mostly defended their views towards YC, OTK and KCM who aggressively demanded changes in the company. During shareholder activism, the Board engaged and disagreed with all shareholder activists' views and proposals. This was due to the instability of the company's governance and financial problems that challenged the Board's operation. On two occasions, shareholder activists (OTK and KCM) attempted to take over control of the company's Board, thus quickening their intentions to sell the company. However, the Board argued that both the activist's suggested nominees lacked relevant experience and in KCM's attempt it believed that the fund's proposed panel could impair the company's value. The management of many publicly listed companies believe that activists lack the expertise to understand their targets and view activism as a threat to their jobs or independence (Sorkin, 2015).

All Boards employed tactical defences as defence mechanisms to minimise the pressure from shareholder activists and satisfy their shareholders. SHR’s Board sold one of their assets to Cascade Investment that triggered further pressure from the activist. Similarly, IHG employed tactical defences such as selling key assets, acquisition of other brands and creation of new brands, whereas, MOR refinanced two of its properties to pay off a debt that the company had.

In addition, the Boards’ employed legal defences as a defence mechanism. Shareholder activists’ media campaigns and statements forced SHR’s and MOR’s Boards to engage with them and approve an amendment to their companies’ shareholder rights agreements (poison pill). The amendments pleased all shareholder activists and their agendas as a poison pill could undermine any possible sale processes and showed engagement towards the future of the companies. Pressure by shareholder activists may lead the Board to adopt poison pills in response to control-seeking shareholders (Lu, 2016).

Bratton and McCahery (2015) argue that good shareholder relations and constant monitoring are another defence mechanism for Boards but equally important for activist hedge funds. There is evidence in the cases here that both shareholder activists and Boards reached out through presentations to investors and shareholders increasing their chances of engaging and influencing stakeholders. MOR’s Board made presentations to ISS, and to investors about the action and improvements taken by its Board during their tenure before the Annual Meeting of Shareholders in response to KCM’s intervention.

8.7 Company Changes

Dealing with shareholder activists results in various changes as the target company will have to take decisions regarding its future in order to respond to activist interventions. In all cases, the Boards took decisions when the pressure begun to escalate. Based on the analysis of the cases, shareholder activists identified vulnerabilities and aimed to improve three areas in a target company: financial and operational performance and governance structure. Their impact resulted in several changes – minor and major – that were related to the areas that shareholder activists pursued to improve (see Table 8.6).

Table 8.6 Company Changes

Company	Minor Changes	Major Changes
Strategic Hotels & Resorts		
Financial and Operational Performance	Sale of the Four Seasons Punta Mita Resort and Grosvenor House.	1. Improved financial performance (Revenue, Profit and EBITDA margin). 2. 40% share price increase. Generated a premium price per share as proposed by OC. 3. Sale of the company.
Governance Performance	1. Agreed to appoint David W. Johnson to the company's Board of Directors. 2. Approved an amendment to the company's stockholder rights plan to accelerate the expiration. 3. Independent review of executive compensation and redemption of the company's Series A Preferred Stock.	
InterContinental Hotels Group		
Financial Performance and Operational Performance	1. Acquired Kimpton Hotels & Restaurants for $430 million. 2. Sale of assets equivalent to approximately 10% of the company's market capitalisation prior to Trian's involvement.	1. IHG delivered a 26% total return to investors. Over a 10 year period it handed back to shareholders more than £10 billion in dividends. The company kept buying back stock: had completed the latest $500 million repurchase on 29 May 2013. 2. Continued its asset-light strategy. 3. In 2014, IHG returned more than $1bn to shareholders.
Morgans Hotel Group		
Financial and Operational Performance	The company borrowed $450 million against two of its properties to pay off its debt.	
Governance Performance	1. Filed their definitive proxy statements in connection with the 2014 Annual Meeting of Shareholders. 2. Entered into an amendment to the Shareholder Rights Agreement. 3. In 2015, Richard Szymanski temporarily served as CEO. 4. In 2015, announced the appointment of Howard Lorber (as Chairman).	1. Shareholders elected OTK's entire panel (7 nominees). 2. In 2016, election of the new Board of Directors. 3. Sale of the company.

The Boards agreed to take several decisions associated with their financial and operational performance and corporate governance structure. The decisions taken by the Boards confirm the problems and/or challenges they were facing, and shareholder activists addressed during their interventions. Despite the above, the changes which emerged were the result of different actions taken by all Boards. For example, the companies sold part of their portfolio for different reasons (Bebchuk et al., 2015). SHR and MOR took this decision to reduce their debt, whereas, IHG supported its asset-light strategy and funded its expansion. Hedge fund activism is about value while governance and the processes of capital market discipline take second place on the agenda (Bratton, 2010).

Shareholder activism and the actions taken by the Boards also influenced the share price of all companies both in the form of minor and major changes. Minor changes were the result of the entry of shareholder activists, allegations that they made to the Boards about each company's financial performance. On the other hand, major changes were the result of the impact of shareholder activists from their entry to their exit from their targets. Table 8.7 presents the long-term outcomes of the share price based on the impact of shareholder activism. Most shareholder activists held their stake in their targets for a short period, ranging from 10 months (TFM) to 3.5 years on one occasion. A sample of activist events by Boyson and Mooradian demonstrated that the average activism period is slightly over two years in length (Boyson and Mooradian, 2011).

Table 8.7 Share Price During Shareholder Activism

Target	Activist	Share price on initial activist's intervention	Share price on the day of activist's exit	% Change
Strategic Hotels & Resorts	Orange Capital	$6.70 (14th January 2013)	$11.22 (2nd June 2014)	67.4
Intercontinental Hotels Group	Trian Fund Management	$33.36 (14th May 2012)	$39.98 (4th March 2013)	19.8
Intercontinental Hotels Group	Marcato Capital Management	$50.60 (19th May 2014)	$44.41 (7th September 2015)	-12.2
Morgans Hotel Group	OTK Associates	$14.87 (11th February 2008)	$2.25 (30th November 2016)	-84.8
Morgans Hotel Group	Yucaipa Companies	$3.61 (16th November 2009)	**YC and SBE acquired MOR** (30th November 2016)	N/A
Morgans Hotel Group	Kerrisdale Capital Management	$5.54 (11th February 2013)	$2.25 (30th November 2016)	-59.3
Morgans Hotel Group	Rambleside Holdings	$5.63 (3rd August 2015)	$1.31 (30th November 2016)	-76.7

Shareholder activism is likely to increase a company's share price after the exit of a shareholder activist (Cheffins and Armour, 2011; Levine, 2015) but this is not evident in all cases. In SHR's case, OC's exit resulted in a 67.4% increase in the company's share price since the fund's entry. A similar pattern was evident in IHG's case, as when TFM exited the company, IHG's share price increased by 19.8%. In contrast, MCM's exit resulted in a -12.2% share price decrease for the fund. Similarly, in MOR's case, the company's share price decreased substantially after each shareholder activist's initial investment into the company. Despite the variances in the share price paid by each shareholder activist, their exit from MOR coincided with the sale of the company to SBE and as a result, all had been paid $2.25 per share, substantially less than their initial investment in the company.

The impact of shareholder activism leads to the emergence of various changes in financial, operational and governance areas. The changes are the result of continuous pressure exerted by shareholder activists and the intentions they have about their targets. In the case companies, most of the shareholder activists achieved their initial demands (e.g., sale of the company, share price improvement) on their targets and exited the companies with a return on their investment. It was the interaction with the Boards that proved to be important for the emergent outcomes and a guide for the journey of shareholder activism in increasing shareholder value.

8.8 Enabling Environment

In order to understand what worked and what did not in all cases during shareholder activism, this study has identified enablers that enabled the Boards to manage change and inhibitors that have restrained their ability to manage change in relation to activists' attacks (see Table 8.8). These enabling conditions together contributed to the creation of a co-evolving enabling environment or infrastructure (Goergen et al., 2010; Mitleton-Kelly and Papaefthimiou, 2002).

Table 8.8 Enablers and Inhibitors

Enablers	Inhibitors
Openness and engagement	Non-transparent governance
Exploration of opportunities	Financial instability
Structure	Underperformance
Autonomy and support	Unstable leadership
Stability	
Widely accepted strategy	

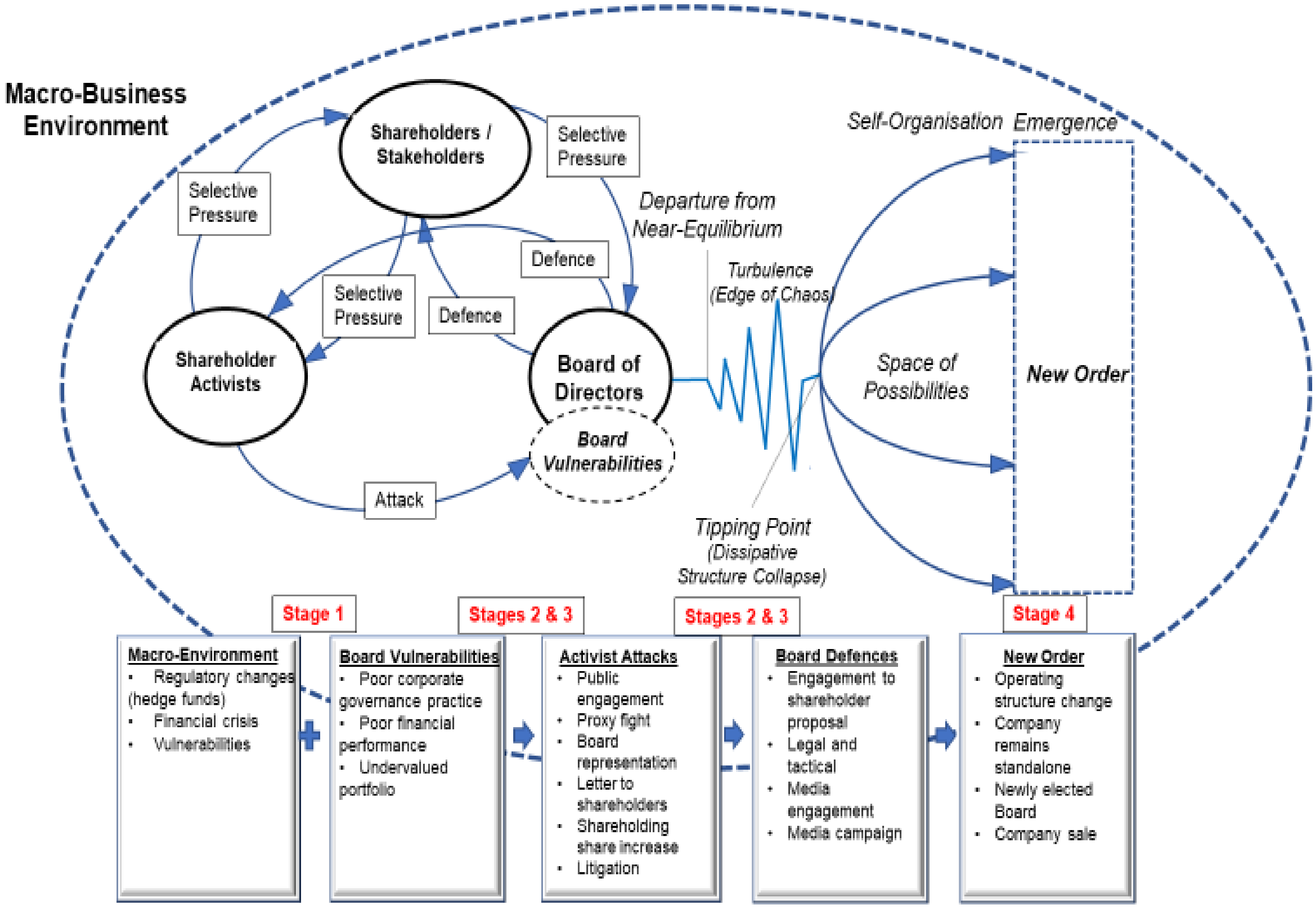
There are several enablers identified in this study from the analysis and discussion of the cases. Regardless of their intentions, all Boards engaged in dialogue with shareholder activists and considered their strategic proposals (openness and engagement). They explored opportunities (sale and acquisition of assets) in the business environment to withstand the pressure from shareholder activists and to minimise their financial, operational and corporate governance challenges (exploration of opportunities). The Boards demonstrated a structured approach when responding to shareholder activists' demands and tactics and media and analysts' speculations (structure). The CEO and other senior leaders of each target company represented each Board, the companies and their shareholders in their responses demonstrating autonomy and support. Another enabler that was demonstrated from IHG during shareholder activism was the Board's stability and the fact that its asset-light strategy was widely accepted by the company's shareholders. Some of the enablers identified in this study correspond Mitleton-Kelly's (2003) case study findings of an international bank which had to upgrade the information systems of its operations.

On the other hand, several inhibitors also challenged the Boards' ability to effectively face shareholder activists. SHR's Board's non-transparent governance practices such as the sale of a hotel asset to an existing shareholder exerted further pressure by the shareholder activist. Financial instability such as long-term debt and underperformance compared to their peers were signs of weakness for the companies and their Boards when interacting with shareholder activists and other stakeholders. Finally, a Board's (MOR) unstable leadership demonstrated a sign of weakness and a disadvantage when dealing with shareholder activists.

8.9 Integrated Model of Shareholder Activism

Leading on from the dynamic analysis and discussion, a model has been developed which places shareholder activism at the core of corporate governance, and through the complexity lens, it looks at the simultaneous interaction of the Board with shareholder activists, other shareholders and stakeholders that are part of a company's social ecosystem. The discussion below explains the construction of the model depicted in Figure 8.2.

Figure 8.2 Integrated Model of Shareholder Activism



The major elements of the integrated model are the Board of Directors and other shareholders and stakeholders and it captures their interactions through the process of a shareholder activist attack. These interactions are sensitive to macro-environmental conditions as suggested by Mitleton-Kelly (2003). The non-linear relationships and interactions of the major elements are exhibited by dynamic loops – selective pressures, shareholder activism attacks and defence mechanisms – that may take place simultaneously or at different periods and characterise each element's choices during the Board's evolutionary trajectory. The model also illustrates the entry of a shareholder activist in a public listed company which begins with macro-environmental conditions, it presents the Board's vulnerabilities, activist attacks and the Board's defences. The shareholder activism journey concludes with the emergence of new order and the exit a shareholder activist from the target company. Activist attacks and the Board's defences usually take place more than once during the Board's evolutionary trajectory. The model also demonstrates the four conditions identified in the template framework (see Table 4.3) and their relation to the stages that have been identified during the analysis and discussion of the case studies.

Prior to a shareholder activist attack, the Board operates near equilibrium conditions and its operation and management is not under threat. Similar to any other complex system, the Board is sensitive to initial conditions. Macro-environmental conditions and a Board's vulnerabilities trigger the interest and facilitate the entry of shareholder activists into a company. Shareholder activists' initial interest also amplify the interest from various stakeholders and forces the Board to depart from near equilibrium conditions that are generally stable and move to an unstable state – far from equilibrium conditions.

A Board's move to far from equilibrium conditions is, in many cases, the result of both shareholder activist attacks and the selective pressure of stakeholders who force the Board to change its behaviour. In response to an attack, the Board will usually take a defensive stance and apply negative feedback to demands and/or speculations in order to maintain stability in its governance structure, therefore attempting to return the system to a near equilibrium state. Often a Board's defence mechanisms are not effective and attract further interest from activists and from other shareholders and stakeholders. The increased interest acts as a positive feedback mechanism and results in behavioural iterations in the Board's structure that amplify the disruption leading to further changes and disorganisation of the system. In order to maintain order and stability in their structure, Boards adopt additional defence mechanisms associated with their financial or governance performance.

From a near to a far from equilibrium state, the Board's dissipative structures import energy in the form of pressure/attacks exerted by shareholder activists and export entropy in the form of defence mechanisms in order to maintain order and stability and possibly return to a near equilibrium state. Some Boards will be able to maintain the dissipative structure of their system. However, other Boards may have dissipative structures which result in them not being able to handle the pressure exerted by shareholder activists. The latter may eventually collapse, although they will retain their property which will later form the foundation for self-organisation.

Continuous activist attacks drive the Board to turbulence by forcing it to operate at the edge of chaos to find ways to respond to shareholder activism. At the edge of chaos, as shareholder activists look to implement their agendas in the target company, they will usually take a more aggressive approach in order to influence Board members and other shareholders and stakeholders. The exact approach that activists adopt and pursue, depends on the vulnerabilities and opportunities they have identified in the target company prior to their entry and to the effectiveness of defence mechanisms during their presence in the company.

At the edge of chaos, some Boards will acknowledge the significance of activists' interventions in order to minimise and prevent further attacks that are likely to further disrupt their structure. In this state, there are some Boards whose dissipative structures are weak. They will not be able to maintain the integrity of their existing structure because their defence mechanisms are not effective. At the edge of chaos, a return to stability becomes difficult and Boards reach a tipping point and their dissipative structures usually collapse. Consequently, a Board will disintegrate, and re-structure will be considered necessary. However, there will always be Boards that will not disintegrate when they reach the edge of chaos, being able to adapt and evolve in line with macro-environmental changes. They will be able to survive and keep their structure intact.

When a Board crosses a tipping point, its agents 'spontaneously come together' to explore new solutions in order to establish a dynamic balance within the company's corporate governance ecosystem. The exploration of alternatives in the self-organisation process is an attempt by Boards to maintain their status quo by keeping shareholder activists and their shareholders satisfied and to return their systems to a near equilibrium state. During the self-organisation process, some of the alternatives explored may be similar to the ones taken previously by the Board. Self-organised processes lead to the emergence of new order which can take many forms depending on the impact of shareholder activism and the condition of the Board and the target company.

The result of the Board's interactions and relationships with shareholder activists and other stakeholders throughout shareholder activism gives rise to enabling conditions, for example, enablers, which enable Boards to manage change, and inhibitors which restrain their ability to manage change. Both enablers and inhibitors must be identified and enablers kept in place and inhibitors removed. Together with other conditions, such as political and economic, enablers and inhibitors collectively create an enabling environment that encourages and supports Boards to face shareholder activism with appropriate practices and enable the daily running of an organisation.

8.10 Summary

This chapter discussed and evaluated the research findings of this study. It demonstrated that the impact of shareholder activism is of great importance and taken seriously by corporate boards and other stakeholders in a company's corporate governance ecosystem. The analysis and discussion of the cases through a complexity lens provided a comprehensive view of the interaction between Boards, shareholder activists and other stakeholders, both primary and secondary. During shareholder activism, shareholder activists and other stakeholders influenced Boards, but at the same time, Boards also influenced the above agents.

The investigation of the three cases demonstrated the journey of a shareholder activist when attacking a company and confirms the discussion in the literature review in

Chapter 2. Two shareholder activists (YU and OTK) with different ownership structures and motives employed an effective shareholder activism approach indicating that the phenomenon is not always employed by hedge funds. Other agents such as private equity funds or real estate companies with a shareholding position employ shareholder activism not necessarily only to grow their investment returns but to lead a company out of troubling conditions.

This chapter also discussed key factors and events related to shareholder activism that were critical in the evolution of the phenomenon in each case. These include:

- All activist interventions began in 2012.
- The Boards <u>vulnerabilities</u> that attract shareholder activists. Financial and operational performance and corporate governance performance were addressed by all activists in this study.
- Board vulnerabilities prompted shareholder activists to attack them and employ <u>tactics</u> that are common practices and some of which were similar to all cases. <u>The study found how corporate Boards made decisions and adapted their tactics during shareholder activism, which was the result of their interaction with shareholder activists. remove</u>
- Boards' <u>defence mechanisms</u> in order to prevent or minimise the impact of shareholder activism. All Boards' engaged with activists and applied various tactics that were relevant to their strengths such as media campaigns and tactical and legal defences.
- A common pattern in all cases was the <u>exploration of opportunities</u> by the Boards. Under pressure from activism, all companies started to sell their assets

to reduce their debt or fund their expansion or increase their dividends to their shareholders.

The impact of shareholder activism in the case companies displayed enabling conditions, enablers and inhibitors that can influence Boards when facing shareholder activism. These conditions vary depending on the approach that shareholder activists adopt and how resilient a company is. Based on the above discussion, the next chapter presents the conclusions of this study and provides several recommendations for theory, practice and further research.

CHAPTER NINE - CONCLUSION

9.0 Introduction

This chapter aims to bring together the findings reviewed by highlighting the contributions of this study and identifying areas for further research. The chapter begins by discussing the contributions this study makes to the 'body of knowledge'. It then provides recommendations for researchers and for practitioners. It concludes by reflecting on the learning gained during the research process. In order to achieve the aim of the study, five main objectives were set and accomplished.

1. The study reviewed the literature on corporate governance and on complexity theory and viewed corporate boards as complex co-evolving systems with their own agenda and supporting a function in the corporate governance ecosystem of each company. As complex co-evolving systems (CCES), Boards not only adapted to changes that occurred in their corporate governance ecosystem, but they also learnt and evolved from every change and therefore influenced their environment.
2. This study constructed three cases of 'offensive' shareholder activism from the international hotel industry, examined the reaction of corporate boards and gauged the impact this had on the specific corporate governance ecosystem through the collection of online documentary information.
3. The analysis of the findings was accomplished by using complexity theory and its principles. The study constructed a template framework and found that multiple interacting dimensions of the 'new order' were created by corporate boards because of the impact of shareholder activism.

4. The impact of 'offensive' shareholder activism led to the identification of enablers and inhibitors in the Boards' trajectories that contributed to the creation of a co-evolving enabling environment which supports and encourages good governance practices.
5. Finally, an integrated model of shareholder activism was proposed which allows corporate boards to comprehensively explore the impact of 'offensive' shareholder activism and enable them to withstand and prevent shareholder activism attacks.

This study provides novel insights into and interpretations of the impact of 'offensive' shareholder activism on a company's corporate governance ecosystem. By utilising a template framework as a methodological tool, it proposes an integrated model of shareholder activism that will enable corporate boards and corporate governance ecosystems to deal effectively with shareholder activism.

9.1 Contributions of the Study

This study makes three main contributions. The first relates to shareholder activism theory where an integrated model of shareholder activism is proposed and offers researchers and practitioners a comprehensive view of the impact of shareholder activism to corporate boards. The study also makes a methodological contribution through the development and application of a template framework which provides a dimension for the application of complexity theory in corporate governance and shareholder activism studies. The final contribution discusses the implications that this study has for practitioners who engage with shareholder activism. The following sections discusses these contributions.

9.1.1 Contribution to Shareholder Activism Theory

The extant academic literature expressed the view that researchers have employed different theoretical perspectives to explore and explain corporate governance issues, including agency, resource dependency, stewardship and stakeholder theories. These theoretical approaches tend to evaluate a single aspect of the impact of shareholder activism, such as the share performance of a company or financial returns given to investors. Consequently, they reveal a gap in the corporate governance discipline and are unable to capture the complexity and the dynamics of a Board's interactions with shareholder activists and other stakeholders.

This study investigates the impact of 'offensive' shareholder activism comprehensively and examines the interactions of corporate boards with primary and secondary stakeholders in their companies. The analysis and discussion of the findings confirms the view that 'offensive' shareholder activism is disruptive for the Boards of publicly listed companies and influences their decision-making processes. The initial conditions that triggered the interest of shareholder activists and their resulting interventions can be viewed as a four-stage process: i) the identification of a Board's vulnerabilities, ii) the attack of shareholder activists, iii) the defence mechanisms implemented by Boards and iv) the emergence of changes on every company.

The analysis and discussion of the three case studies resulted in the development of an integrated model of shareholder activism. This model places shareholder activism – a corporate governance mechanism – at the core of corporate governance, and by adopting the complexity lens, it looks at the simultaneous interaction of the target

Board with shareholder activists, other shareholders and stakeholders that are part of a company's social ecosystem.

This is the first model that integrates shareholder activism theory and complexity theory in a corporate governance study. The model bridges the gap in the limited application of complexity theory to corporate governance and shareholder activism and provides avenues for further elaboration into other theoretical contexts such as risk and crisis management e.g. examining a company's reactions when faced with a crisis and looking at the causes that create disturbance. It will allow a company to organise its corporate governance structure and processes when it has to engage with shareholder activists. Corporate boards will be able to understand the impact of shareholder activism and implement mechanisms that prevent or minimise the impact of activists' interventions. The proposed integrated model of shareholder activism is distinctive in three ways:

1. The primary elements of this model are the Boards and shareholder activists, whereas secondary elements include other shareholders and stakeholders who also influence the Board's evolutionary trajectory. Over the course of shareholder activism period, the simultaneous interactions of the Board with shareholder activists, and in some cases with secondary elements, result in rich connections.
2. The application of complexity theory and its principles with shareholder activism theory allow practitioners and researchers to identify and understand: i) a Board's vulnerabilities, ii) shareholder activism attacks, iii) a Board's defence

mechanisms and iv) strategic changes or outcomes that may occur in a company.

3. The model adopts a comprehensive approach; it does not look at only one aspect to explore shareholder activism practices and tactics or defence mechanisms, but rather evaluates several aspects which comprise a company's corporate governance ecosystem.

9.1.2 Methodological Contribution

The study adopted an exploratory research approach in order to provide novel insights into and interpretations of the impact of 'offensive' shareholder activism on a company's corporate governance ecosystem. The main methodological contribution of this study is the development and application of a template framework. The template framework (See Table 4.3) allowed this study to view each case company comprehensively and not just focus on the relationship between the Board of Directors and shareholder activists. It uses complexity theory and its principles to develop four complexity stages – initial conditions, from near to far from equilibrium, edge of chaos and beyond and emergence of new order – that show the probable journey of a complex system such as the Board of Directors when it is under pressure by shareholder activists.

The constructed template framework provides a new dimension for the application of complexity theory in corporate governance and shareholder activism studies. It can offer an in depth understanding of the behaviour of all agents and their interactions in a company's corporate governance ecosystem at different stages of shareholder activism interventions. The main advantages of the template framework are the following.

- Wide application. The ability to explore in detail dynamic phenomena such as shareholder activism. With the exception of corporate governance studies, the template framework can be used to explore cases from disciplines such as meteorology (weather and climate events), military studies and finance (financial crises).
- Flexibility in the way it can be designed. The template can give researchers the opportunity to construct questions with phrases such as 'who', 'why' and 'what' that will generate rich data and retain holistic and meaningful characteristics of social phenomena. Therefore, depending on the nature of the investigation it will allow researchers to identify key agents in a target company, their intentions and also outcomes that are likely to emerge from the interaction between shareholder activists and Boards.
- Relevance to longitudinal studies. It is a methodological tool that investigates dynamic phenomena such as shareholder activism interventions that occurred over prolonged periods in the past and may extend in the present.
- Specificity. The template's structure follows a chronological order. Therefore, it explores the initial conditions that trigger the interest of shareholder activists in a company, what events occur during their presence and what are the outcomes that follow with their exit from the target company.
- Enabling conditions. The template framework contributed to the identification and an understanding of the enabling conditions that emerged in each case company. As discussed in Chapter 3, complexity is useful for studying the

evolution of complex organisations and other conditions that add to the complexity of existing organisations (Begun et al., 2003). Apart from the relationship between the Board and different agents, this study looked at a set of social, legal, political and economic conditions that influenced the Board and eventually co-evolved with the external environment of each company.

9.2 Implications for Practitioners

This study has produced a template framework and an integrated model of shareholder activism that will help corporate managers and corporate boards of publicly listed hospitality companies to develop and implement robust and efficient mechanisms in the wake of shareholder activism.

The template framework offers managers a tool to explore in a chronological order the impact of shareholder activism on corporate boards. Over the course of shareholder activism, managers will be able to view comprehensively the Boards' interactions with shareholder activists and other primary and secondary stakeholders. The template framework can be used as a toolkit for managers by asking specific questions in different phases of shareholder activism, therefore gaining insights in the impact of shareholder activism by taking into consideration both the micro and macro environments of the target company.

The application of the integrated model of shareholder activism will provide managers with an understanding of the impact of shareholder activism and the Board's trajectory by looking at its interactions with various agents. As discussed previously, managers will be able to explore several factors that are associated with shareholder activism.

The analysis of the findings resulted in the development of a checklist (see Table 9.1) that Boards can adopt. The checklist is divided into three stages – assess risk, minimise risk/prevent risk and measurement of the impact of shareholder activism. It can prepare a Board for a shareholder activist attack or in the case that an intervention is in progress it can address certain aspects that may create robust defence mechanisms. Following the assessment and minimisation of risk, the checklist recommends measuring the impact that shareholder activism may have on corporate boards and companies.

Table 9.1 Board of Directors Checklist

Task	Sub-Task	Action Plan	Questions
Assess risk	Assessment of the company's vulnerabilities	Assess and evaluate the value of the company's portfolio, corporate governance challenge and financial performance e.g. monitoring share price performance. Identify challenges that may arise from its shareholder base (shareholder satisfaction of how the company is governed). Identify activists that are likely to consider the company a target.	1. Is our portfolio undervalued? 2. Do we have transparent governance practices and comply with corporate governance regulations? 3. How do we perform financially compared to previous periods? 4. What is the share price over a period and how does it compare with our competitors? 5. What are the views of our shareholders and stakeholders about governing the company? 6. Which shareholder activists could be interested in the company? 7. How can we entrench our company? 8. How would we respond to a potential activist attack? 9. How could an activist benefit our company? 10. What macro-economic factors pose a threat for our company?
Minimise / Prevent risk	Upon the activist's entry in the company's shareholder base, the Board must investigate the activist	Conduct research on the activist's past interventions and tactics used to influence Boards and companies.	1. What tactics do they use to influence a Board? 2. Do we need to engage or ignore the initial demands? 3. Which members will respond to the activists?
	Board selection	Consider recruiting and selecting experienced Board members dealing with shareholder activism.	1. What are the criteria for selecting Board members? 2. How many members with previous relevant experience should we select? Do we need a miminum number?
	The Board's response to shareholder activists' attacks	Development and implementation of defence mechanisms.	1. What defence mechanisms do we need to implement? 2. Do we need to install a poison pill? 3. What are the thoughts of our shareholders about the activist's intervention? 4. Who will develop the defence mechanisms? 5. Who will implement the defence mechanisms?
	The Board's options	Available and relevant strategic options at the Board's disposal.	1. Do we settle with activists to avoid a proxy contest? 2. What strategic choices should we make e.g. company sale or part of it, merge with another company, reduce costs? 3. Do we pay cash dividends to our shareholders or do we buy back our shares (share buyback)? 4. Can we afford to fight till the activist exits the company?
Measurement	Measuring the impact of shareholder activism	On exiting the company, the Board must measure the impact of shareholder activism and evaluate its stance over this period.	1. What losses did we have if any? 2. How can we better prepare our company for a potential future attack? 3. Are our shareholders satisfied with the way we handled shareholder activism?

This study suggests tactics that Boards can apply before and during shareholder activism that will enable them to prevent and withstand shareholder activism. Prior to the entry of shareholder activists in a company, Boards must assess and evaluate vulnerabilities that are likely to be influenced by internal and/or external factors and may trigger shareholder activism. In order to understand their vulnerabilities, Boards must have an objective view of their companies and the environment in which they operate. Vulnerabilities such as poor financial performance and operating loss (Chapters 4 and 6), CEO turnover (Chapter 6), transparent practices (Chapter 4) and undervalued portfolios (Chapter 5) act as a magnet for shareholder activists who are looking for targets that have the potential to improve their positions and generate returns on their investments. Boards should regularly assess their companies by commissioning consultants who will provide a thorough analysis of how the company is performing and how vulnerable it can be in the event of shareholder activism. In addition, the company must constantly scan the macro-environment to identify activism trends and be aware of shareholder activists' attacks on any of their competitors.

Boards need to understand the shareholder base of their companies – major and minor shareholders – and monitor and understand their intentions. They should assess the needs of its major shareholders, engage and build relationships with them outside formal annual shareholder meetings, e.g. informal meetings throughout the year. This will allow the Boards to strengthen their relationships with major shareholders who may have Board presence, can play an important role during voting processes, and may be able to support the Boards and their companies during shareholder activism. In addition, Boards must be aware of any changes (entry or exit) in the company's shareholder base. Investors that enter or exit a company may influence its ability to retain Board stability and may change the Board's dynamics. Another point relates to the views of analysts, media and traders that exert influences to all publicly listed companies. Boards must constantly understand how these stakeholders perceive the company and accordingly they must engage and build relationships with them. These stakeholders can influence future investors who may consider investing or even customers who use or want to use the products of their companies. Engaging with these stakeholders will enable the Boards to be aware of challenges that the company has not noticed in the economic environment.

Boards must investigate the activist's history in previous and/or current targets and understand the tactics that they apply to exert pressure to companies. Thorough investigation will enable the Boards to understand what tactics to expect during shareholder activism. When a shareholder activist enters a company, the Boards must engage quickly and respond to the activist's demand/s. Ignoring an activist's demand/s will escalate the pressure and the activist will express their views publicly to generate interest from the company's wider social ecosystem. The study showed that Boards should consider working together with shareholder activists. Discussions with the activist will allow Boards to be aware of the activist's concerns and any plans they have for the company. The Boards must consider that an activist has conducted substantial preliminary work before attacking their company and sometimes they may have even discussed their thoughts with other shareholders.

An open and objective view of all recommendations made by the activist may benefit Boards and their companies. Engaging with the activist requires experienced and robust Boards with members who have sufficient experience in dealing with activist demands. Although, an experienced team is necessary for responding to an activist's demands, the process must comprise the development and implementation of defence mechanisms that relate to the activist's profile and how well the company performs prior or during a shareholder activism period e.g. financial and operating performance, robust governance procedures. Knowing a company's strengths and weaknesses well can allow a company, to be assertive and object activists' demands as happened in IHG's case (See Chapter 5). Last but not least, during shareholder activism a Board will always have at its disposal strategic options that are directly linked to activists' demands and may minimise the effect of activism.

Measuring the impact of shareholder activism can benefit the Board and the company in the long term. This study has shown that shareholder activism may return to a company if it is likely to contribute to higher returns for their investment (See Chapter 5). The measurement of losses or gains will enable the Board to keep or change its stance when engages with activists and may prove useful when exploring strategic options in the future. Equally important is the shareholders' view on how the Board handles activism and whether the practices and tactics used were considered transparent and protective for their investments.

This study also offers corporate governance practitioners the opportunity to act proactively and create an enabling environment that supports and encourages good governance practices. Managers and Boards may identify enablers and inhibitors that can withstand and prevent shareholder activists' interventions and build a robust corporate governance structure. Although shareholder activism practices vary depending on the target's vulnerabilities, enablers can be a positive force for Boards to maintain their structure intact and minimise the impact of activism, while, prompt identification of inhibitors will allow managers to move to changes in the company's structure and/or processes.

This study has identified enablers and inhibitors that if adopted may be used as a blueprint for managers who encounter shareholder activism practices. Enablers include the Board's <u>openness</u> and <u>engagement</u> towards shareholder activists demands. Managers and the Board may engage in dialogues with activists and consider their proposals for the future of their company, as it may be beneficial for them and other shareholders. In order to engage in constructive dialogues, the Board must display a <u>structured</u> approach and <u>autonomy</u> when responding to activists' and stakeholder demands and public comments. Managers must ensure that the Board's structure maintains <u>stability</u> over time and does not undergo changes that are likely to increase its vulnerability. Understanding and engaging with the company's shareholders may generate support for the Board and any mechanisms implemented may be <u>widely accepted</u>. Finally, during shareholder activism managers must <u>explore a range of opportunities</u> available to them and consider the most appropriate.

On the other hand, managers must identify and prevent the adoption of inhibitors that may increase the risk of shareholder activism interventions. Managers must ensure that the Board's and company's <u>governance practices are transparent</u> and meet the country's corporate governance framework. Also, the managers must monitor the company's financial performance as <u>instability</u> and <u>underperformance</u> compared to its peers may trigger shareholder activism and cause disruption to its shareholder base.

Finally, unstable leadership such as high CEO turnover indicates challenges in the Board's structure and may send signals to the market for imperative changes.

Finally, the integrated model will enable the Board and senior management to answer a number of questions which will be useful for the development of their own corporate governance mechanisms. These questions include: "What are the vulnerabilities of a Board which most appeal to shareholder activists?", "How do shareholder activists attack Boards?", "How do Boards resist shareholder activism?", "Why do Boards resort to certain responses under shareholder activism pressure?" and "What can be the potential strategic outcomes of shareholder activism?"

9.3 Implications for Researchers

The lack of research in the combined theoretical areas of corporate governance, shareholder activism and complexity theory demonstrate an interesting although challenging area of research for this study. Despite the above, in the future researchers can investigate several unexplored areas associated with these topics and shed light on avenues that can be of further use for the body of knowledge.

1. The study explored the impact of shareholder activism on corporate boards and among other factors, it identified shareholder activism attacks/tactics and Boards' defence mechanisms. A future study could examine the motives (e.g. financial, strategic, publicity) that influence shareholder activism tactics and attacks and how activists would measure the effectiveness of their tactics. Although, most activists may focus on monetary rewards, there may be others who may measure their attacks by looking into the amount of time they hold shares in a company. In both

cases, they may compare the results of a target with other past holdings that they had in their possession. This study also found that Boards adopt various defence mechanisms to minimise and prevent the impact of shareholder activism. Future research could examine and measure the effectiveness of a Board's mechanisms by focusing on the decline or increase in the company's i) share price performance and ii) portfolio value by comparing the results prior and after shareholder activism.

2. It was found that activist hedge funds play an important role in the international hotel industry and influence the practices of publicly listed companies by pushing them to return dividends to their shareholders, by making changes to their governance structure or demand their sale. It would be interesting for a study to investigate how mutual funds (have different motivations compared to hedge funds) make interventions in companies. Although, mutual funds usually take a long-term approach to their investments, Norton (2019) describes them as the new activist investors. Their tactics and strategies could provide a new insight into shareholder activism research and could be compared to those of hedge funds.

3. This study explored shareholder activism cases from the international hotel industry and found similarities and differences from the activists interventions in the target companies. Future in depth research could investigate cases from other industries and sectors and compare the findings yielded from the international hotel industry.

4. The shareholder activists in the case companies were all based in the U.S. A cross-cultural research study could investigate shareholder activists from different

geographic regions and compare their approaches and tactics when they attack the Boards of publicly listed companies.

5. The study has shed light on cases where shareholder activists invest and intervene in small cap (market capitalisation up to £2bn) and medium cap (market capitalisation up to £10bn) publicly listed companies. Future research could examine the impact of shareholder activism in large cap (market capitalisation over £10bn) companies and examine whether Board vulnerabilities, activism tactics and the outcome of shareholder activism have similarities or differences with the case companies explored in this study.

6. This study proposes a model that integrates shareholder activism theory and the complexity lens in a Board's corporate governance ecosystem. Complexity theory develops core concepts and ideas and as a metaphor its principles and language can facilitate an understanding of various activities in organisations. Research in the future could develop an integrated model that relies on the application of complexity lens and could be applied on disciplines other than corporate governance and shareholder activism. Therefore, proposed models could explore and analyse dynamic phenomena from a complexity lens that influence industries and companies at disciplines such as finance (e.g. the impact of financial crisis), on public health (e.g. the impact of Covid-19) and the food sector (e.g. the impact of food fraud).

9.4 Reflections on the Study

This study has been an exciting yet challenging experience and journey that contributed to the acquisition and exploration of knowledge. However, the researcher managed to gain insights into areas that extend beyond the body of knowledge. The aim of this study was to provide novel insights and interpretations of the impact of 'offensive' shareholder activism on a company's corporate governance ecosystem utilising a complexity theory lens. Without planning to view the study as a business history project, the research process led the researcher to become an '*accidental historian*'. The continuous research on the three cases enabled an understanding of the history of shareholder activism in each case by drawing connections between past, present and future. This process contributed to the acquisition of a cross-temporal perspective in understanding the impact of shareholder activism by using complexity principles and concepts.

In addition, over the course of six years, this study has remained flexible as it tested different frameworks and developed a contingency plan that facilitated the research process. The initial aspiration of this study was to look at five cases from the international hotel industry that were subject to shareholder activism. The data collection from the first two cases resulted in rich information gathered from each case and led the researcher to focus on three cases as the amount of information in presenting each case would occupy a significant part of this study.

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Appendices

Appendix 1 OC's Letter to SHR's Board of Directors

Letter Copy:

Board of Directors
c/o Mr. Raymond Gellein
Strategic Hotels & Resorts, Inc.
200 West Madison Street
Suite 1700
Chicago, IL 60606

February 1, 2013

Dear Mr Gellein:

Orange Capital, LLC ("Orange Capital" or "we") is a research driven investment firm based in New York. As of the date of this letter, we beneficially own 4,500,000 shares in the aggregate of Strategic Hotels &Resorts, Inc. ("Strategic" or the "Company") common stock.

Orange Capital has carefully studied Strategic's ongoing operations, growth prospects, and capital structure. We analysed a variety of strategic alternatives for the Company's unique portfolio of luxury hotel properties, taking into account the cyclical nature of the lodging industry, the scarcity value of the Company's portfolio, possible changes in interest rates, private versus public market valuations for luxury hotel properties and the M&A environment for luxury real estate.

In our view, the best alternative for the Company to maximize shareholder value is an immediate sale of the Company (with 100% of the net proceeds distributed to or otherwise being received by shareholders).

The Company should retain a financial advisor to facilitate the sale process and publicly announce its intention to review strategic alternatives, including a potential sale, as soon as possible.

We believe a sale of Strategic Hotels would likely result in proceeds in excess of $11 per share, or more than 49% above your last closing price. Our analysis is based on a property level valuation using cap rates, per key valuation metrics, and comparable M&A transactions. Our analysis suggests that on a weighted average basis, the portfolio is worth **$590k-$675k per key.** We believe that a sale for that price is achievable and represents the best path to maximizing value for Strategic's shareholders for the following reasons:

- Private market values for luxury hotel properties far exceed public market valuations.
The demand for luxury real estate has never been greater and recent private market transactions for hotels are near to or above their previous highs. Private market buyers rely on value per key/replacement cost and discounted cash flows rather than current year EV/EBITDA multiples. We believe it is highly unlikely that Strategic's replacement cost value would be reflected in the public markets, particularly given that the Company's private market EV/EBITDA multiple would be higher than any publicly traded peers. Strategic's public market valuation is also impaired by the lack of any comparable pure-play luxury hotels peer group.

- There is a large pool of well-capitalized buyers for the Company's luxury hotels.
Sovereign wealth, pension, endowment, and insurance funds are natural owners and active buyers of luxury real estate. These buyers have outstanding access to global capital markets. In addition, absolute financing costs for highly rated real estate owners are at all-time lows. This is evidenced by low long-term interest rates and the tight credit spreads of well-capitalized REITs.

- Strategic is burdened with material corporate overhead diluting shareholder returns.
Strategic's corporate overhead is approximately $30 million per year. There are meaningful synergies associated with a sale to an existing owner of hotel properties. In the event of a portfolio sale, the vast majority of this overhead would be eliminated. We assume $20 million of cost savings in a sale at 15-18x EBITDA. This would be worth $1.50 - $1.75 of value per share, or approximately 25% of your current market capitalization.

- Strategic's large portfolio of luxury hotels is unique and has outstanding scarcity value.
We believe the bulk sale of Strategic's hotel portfolio presents a rare opportunity for buyers of luxury properties. According to our industry research, it might take up to five years to accumulate a similar portfolio of trophy assets. As a result, we would expect a substantial premium in the event of a sale.

- The Company has a material cost of capital disadvantage compared to other owners of luxury hotels.
Strategic's access to the capital markets is limited by the Company's high leverage ratios relative to current cash flows. In addition, there is strong evidence that REIT stocks with high financial leverage trade at lower multiples of AFFO[1] relative to their

peers. As a listed owner of property assets, Strategic's value as a going concern rests on its ability to finance accretive acquisitions or pay dividends from current cash flows. Neither is likely in the near term in any meaningful amount. Strategic's share price remains well below its intrinsic value, so any equity issuance would be highly dilutive for shareholders.

- Strategic's leveraged balance sheet offers few prospects for a return of capital to shareholders for the foreseeable future.
The Company's credit facility limits Strategic's ability to repurchase common stock or pay dividends to common shareholders. Strategic's high leverage impairs the Company's access to new or amended financing agreements.

- Strategic lacks brand value.
There is no unique value associated with the "Strategic Hotels" brand. The Company is simply a listed fund with the highest cost of capital in the luxury hotel industry.

- Management lacks a credible plan for creating shareholder value.
Following the recent departure of your CEO, Strategic has failed to articulate a strategy to increase shareholder value. We do not believe wagering that EBITDA will return to its previous cyclical highs is a credible deleveraging strategy. Given the Company's weak balance sheet and limited access to low cost capital, we see no viable alternative to a sale.

We did not arrive at this conclusion without evaluating other possible alternatives. We also considered Strategic continuing on its present course with the expectation of improving industry conditions as well as a partial sale of the Company's portfolio with proceeds used to retire debt.

We do not believe that the status quo is in the best interests of shareholders. There are significant risks associated with the hotel cycle, changes in property values, capital markets conditions, and interest rates. This is especially the case when many prospective buyers of luxury assets are currently willing to buy assets at prices already reflecting a positive cyclical outlook.

While a partial sale of the Company in a deleveraging transaction would likely allow for renewed access to the equity capital markets on more reasonable terms, we see this is as a poor alternative to a full sale. Strategic's smaller pro-forma asset base would be sub-optimal for REIT investors in the public markets. In addition, there may be costs associated with the early repayment of indebtedness and the Company's stock would remain one of the less liquid names in the public REIT space.

We would be pleased to discuss our views as expressed in this letter with you at your earliest convenience.

Sincerely,

Daniel Lewis
Managing Partner
Orange Capital LLC

Source: Business Wire (2013a).

Appendix 2 Orange Capital Issues Statement Regarding Strategic Hotels & Resorts

Deficiencies in its business strategy and corporate governance

1. Six months have passed since the Company announced its intention to sell an asset from its portfolio to repay indebtedness. To date, no asset has been sold nor has an asset been publicly identified for sale.
2. Strategic Hotels has yet to publicly announce that it has retained a financial advisor and is willing to explore a sale of the Company. For reasons stated in our previous releases, we believe a sale is by far the best path to realize the full value of Strategic Hotel's scarce collection of luxury hotels and resorts.
3. For three consecutive years, Institutional Shareholder Services has highlighted the executive "pay-for-performance disconnect... due to guaranteed equity grants, increases in long-term equity incentive values, poor benchmarking practices and culmination of the Company's Value Creation Plan, which provides excessive awards unlinked from Company performance."
4. Excessive corporate overhead costs that dilute shareholder returns.

Source: Business Wire (2013b).

Appendix 3 Orange Capital Reports Results of Potential Buyer Contacts for Strategic Hotels & Resorts

Orange Capital LLC, holder of approximately 3.7% of Strategic Hotels & Resorts, Inc. ("Strategic Hotels") (NYSE: BEE), has sent the following letter to the independent members of the Board of Directors of Strategic Hotels:

July 16, 2013

Independent Members of the Board of Directors
Strategic Hotels & Resorts, Inc.
200 West Madison Street, Suite 1700
Chicago, Illinois 60606-3415

Dear Members of the Board:

As you know, Orange Capital LLC ("Orange Capital") continues to strongly believe that a broad and thorough process to explore a potential sale of Strategic Hotels & Resorts, Inc. ("Strategic Hotels" or the "Company") is imperative. Our reasons have been outlined in our prior letters to you.

We were initially encouraged when both the Wall Street Journal and Reuters reported in mid-June that the Company hired Eastdil Secured to pursue a potential sale of the whole Company. Since these media reports surfaced, Strategic Hotels has failed to confirm or deny the media reports of a sale process and clarify what process, if any, is being conducted. By not doing so, the Company has created significant uncertainty as market participants continue to buy and sell Strategic Hotel's shares with what we believe is neither reasonable transparency nor appropriate disclosure. We believe that it is the responsibility of the independent directors to ensure that shareholders are promptly informed of the scope of any process being pursued so that they are able to make responsible investment decisions.

Given Strategic's failure to respond to these media reports and the Company's history of poor corporate governance, we felt compelled to retain our own financial advisor, Houlihan Lokey, to represent us. Houlihan Lokey's mandate, among other services, is to assist us in evaluating potential interest in the Company.

Houlihan Lokey has been in contact with more than ten of what it believes are logical "Tier A" buyers for the Company. In summary, Houlihan Lokey reported to us that there is a broad spectrum of interest in the Company. However, Houlihan Lokey also informed us that there is significant confusion by certain potential buyers as to: (i) whether any process is underway, (ii) whether or not the Company is seriously interested in a transaction for the Company as a whole, (ii) which advisor(s) has been retained by the Company and (iii) any specific process or schedule around a potential sale.

In addition, based on Houlihan Lokey's outreach to the most likely buyers, we believe that many of these potential buyers have not, even to their own surprise, been contacted by the Company or its advisor(s). As a result, assuming that the media reports of a "sale process" are true, we are highly concerned that Strategic Hotels may be embarking on a limited process, potentially for only select assets or only with certain types of buyers. We believe it is the responsibility of the independent directors to ensure that any sale process is reasonably designed to maximize value for all shareholders.

We again urge the Company to promptly (i) confirm or deny the reports from Reuters and The Wall Street Journal that it retained an advisor to pursue a sale, (ii) announce which firm or firms the Company has retained and the scope of their mandate and (iii) have the Company's advisor(s) contact all logical buyers to inform them that a sale process for the whole Company will be conducted and when the dates that materials would be made available for review.

We look forward to seeing evidence of such transparency in the days ahead.

Sincerely

Daniel Lewis,
Managing Partner

About Orange Capital LLC

Orange Capital, LLC is a New York based investment firm. The firm is a value-oriented investor in event-driven securities. The firm allocates across the capital structure on an opportunistic basis. Orange Capital was co-founded in 2005 by Daniel Lewis and Russell Hoffman. Prior to founding the firm, Orange Capital's portfolio manager, Daniel Lewis, was a director with Citigroup's Global Special Situations Group.

About Houlihan Lokey

Houlihan Lokey is an international investment bank with expertise in mergers and acquisitions, capital markets, financial restructuring and valuation. The firm serves corporations, institutions, and governments worldwide with offices in the United States, Europe, and Asia. Independent advice and intellectual rigor are hallmarks of our commitment to client success across our advisory services. Houlihan Lokey is globally ranked as the No. 1 restructuring advisor, the No. 1 M&A fairness opinion advisor over the past 10 years, and the No. 1 M&A advisor for U.S. transactions under $3 billion, according to Thomson Reuters.

Source: Market Watch (2013)

Appendix 4 Morgans Hotel Group IPO

Morgans Hotel Group Co. is providing you with the following information in connection with its initial public offering.

Morgans Hotel Group Co.
$360,000,000
18,000,000 Shares

Issuer:	Morgans Hotel Group Co.
Symbol:	MHGC
Size:	$360,000,000
Shares offered by the Issuer:	15,000,000 shares
Shares offered by the selling stockholders:	3,000,000 shares
Greenshoe[65]:	2,700,000 shares; option to purchase additional shares from Morgans Hotel Group Co.
Price to public:	$20.00 per share
Underwriting discounts and commissions:	$1.30 per share
Trade date:	February 13, 2006
Closing date:	February 17, 2006
CUSIP:	61748W108
Underwriters:	Morgan Stanley & Co. Incorporated Merrill Lynch, Pierce, Fenner & Smith Incorporated, Citigroup Global Markets Inc., Banc of America Securities LLC Thomas Weisel Partners LLC, Jefferies & Company, Inc., JMP Securities LLC Blaylock & Company, Inc. E*Trade Securities LLC Susquehanna Financial Group, LLLP

[65] In security issues, a greenshoe option is an over-allotment option. In the context of an initial public offering, it is a provision contained in an underwriting agreement that gives the underwriter the right to sell investors more shares than originally planned by the issuer if the demand for a security issue proves higher than expected.

The following information updates the information describing our proposed indebtedness following this offering.

Mortgage and Other Indebtedness Outstanding After This Offering

Our $80.0 million management company term loan and our $125.0 million revolving credit facility were proposed to have been secured by pledges of equity interests in certain of our subsidiaries. Our ability to provide the requested pledges is subject to the satisfaction or waiver of certain conditions under the terms of our mortgage debt (including that we receive "no-downgrade" letters from the ratings agencies with respect to the securitization facilities in which our existing mortgage indebtedness has been included and that the maturity date of these new loans is later than the maturity date of the mortgage debt) and these conditions have not yet been satisfied or waived. Our lenders have agreed to make the loans on an unsecured basis. We and our lenders have agreed to use commercially reasonable efforts to satisfy the required conditions (or obtain relevant waivers) as soon as practicable. If we have not provided the requested pledges by April 1, 2006, the interest rate on the term loan and drawings on the revolving loan will increase from 200 basis points to 350 basis points over LIBOR until we provide the requested pledges. An increase of 150 basis points on our management company loan would increase our annual interest expense by approximately $1.2 million. We expect that our revolving credit facility initially will be undrawn. If that facility were fully drawn, an increase of 150 basis points on our revolving credit facility would increase our annual interest expense by approximately $1.9 million.

To review a filed copy of our current registration statement, go to the following link: http://www.sec.gov/Archives/edgar/data/1342126/000104746906001676/a2166502zs-1a.htm

THE ISSUER HAS FILED A REGISTRATION STATEMENT (INCLUDING A PROSPECTUS) WITH THE SEC FOR THE OFFERING TO WHICH THIS COMMUNICATION RELATES. BEFORE YOU INVEST, YOU SHOULD READ THE PROSPECTUS IN THAT REGISTRATION STATEMENT AND OTHER DOCUMENTS THE ISSUER HAS FILED WITH THE SEC FOR MORE COMPLETE INFORMATION ABOUT THE ISSUER AND THIS OFFERING. YOU MAY GET THESE DOCUMENTS FOR FREE BY VISITING EDGAR ON THE SEC WEB SITE AT WWW.SEC.GOV OR BY GOING TO THE LINK ABOVE. ALTERNATIVELY, THE ISSUER, ANY UNDERWRITER OR ANY DEALER PARTICIPATING IN THE OFFERING WILL ARRANGE TO SEND TO YOU THE PROSPECTUS IF YOU REQUEST IT BY CALLING TOLL-FREE 1-800-584-6837 (RETAIL INVESTORS) OR 1-866-718-1649 (INSTITUTIONAL INVESTORS) OR BY EMAILING PROSPECTUS@MORGANSTANLEY.COM.

February 13, 2006

Source: SEC (2006)